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SOCIOECONOMIC REGULATIONS AND THE FEDERAL PROCUREMENT MARKET

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LETTER OF TRANSMITTAL

NOVEMBER 27, 1984.

To the Members of the Joint Economic Committee:

I am pleased to transmit a study entitled "Socioeconomic Regulations and the Federal Procurement Market." The study was prepared by Dr. Robert Premus, former JEC staff economist; Dr. David Karns, Wright State University; and Anthony Robinson, Small Business Administration.

There has arisen over the past decade considerable controversy and debate over the appropriateness of requiring Federal Government contractors to comply with a myriad of "socioeconomic laws" when they sell goods and services to the Federal Government.

This study is based upon a nationwide survey of small business Federal contractors conducted in 1982. The study found that trying to leverage Federal Government purchasing power to achieve social goals is largely ineffective and counterproductive. The primary impacts of these socioeconomic laws are to raise the cost of Federal Government procurement, and discourage new firms from entering the procurement market.

The views expressed herein are those of the authors, and do not necessarily represent the views of the Joint Economic Committee, its Members, or the respective organizations of the authors.

Sincerely,

ROGER W. JEPSEN,
Chairman, Joint Economic Committee.

FOREWORD

By Senator Roger W. Jepsen

Federal Government procurement and social policy cannot easily be merged. When they are merged, the result is detrimental to the procurement process and to the achievement of the social objectives of government. This is the primary conclusion of the study by Premus, Karns, and Robinson, contained in this report. The authors urge that the Congress take immediate action to halt growth in socioeconomic regulations until a full Congressional investigation of each of the socioeconomic goals attached to the Federal procurement process is completed.

A major finding of the study is that Congressional attempts to use Federal Government purchasing power to achieve social and economic goals is costly and ineffective. Attaching socioeconomic regulations to the procurement market is costly to the Federal Government because the regulatory costs are passed onto Government in the form of higher procurement costs. The socioeconomic regulations are costly to firms because the associated paperwork and uncertainty results in a diversion of entrepreneurial and managerial resources away from other firm functions, such as production management, market development and technological innovation. As a result, product quality, market development, and technological innovation, at the firm, tend to suffer from less managerial attention.

The cost of procurement regulations to society include higher taxes to pay for more costly government goods and services, and reduced commercial "spin-off" activity from the government vendor community. Job growth, productivity growth, and private market expansion are less than they would be without the diversion of entrepreneurial and managerial resources of firms to meet regulatory requirements.

In fact, procurement regulations may actually work against those groups and individuals in society who are the intended beneficiaries of these programs. The increase in procurement costs from socioeconomic regulations provides an incentive for the Federal Government to avoid contracting out for commercially provided goods and services. Government in-house provision of goods and services creates more government jobs, but commercial spin-off activity is sacrificed in the process. The result of slower economic growth is fewer jobs for depressed regions and unemployed members of the labor force. In addition, enacting socioeconomic legislation to solve social problems has great appeal in Congress. It gives the appearance that the Congress is taking definitive actions to overcome inequities and achieve social goals; however, the warnings echoed in many studies—including this report—that socioeconomic laws are not working continue to go unheeded in Congress.

The result of much Congressional motion and little action is a diversion of the public policy debate on social and equity issues away from potentially more effective, and less costly, solutions.

For these reasons, I wholeheartedly concur with the main conclusions of this study. The call for a moratorium on further increases in socioeconomic regulations pending a full Congressional investigation of the effectiveness of existing regulations is particularly noteworthy. In my opinion, an evaluation of the effectiveness of current socioeconomic programs appended to the procurement market ought to include a full assessment of the benefits and costs of alternative approaches to solving social problems.

In the final analysis, this study is not an attack on the social goals of society, nor is it an attack on the role of the Federal Government in seeing to it that these goals are met. Rather it is an attack on the current means by which the Federal Government is attempting to carry out social policy. The study concludes that attempts of the Federal Government to use the leverage of its vast purchasing power to force changes in corporate social policies is largely misdirected and ineffective. As an alternative, Premus, Karns, and Robinson argue for less emphasis on the procurement market to achieve social goals and more emphasis on direct mechanisms such as "targeted" Federal, State, and local government tax and expenditure programs, corporate volunteerism, and community action groups.

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SOCIOECONOMIC REGULATIONS AND THE FEDERAL PROCUREMENT MARKET

By Robert Premus, David Karns, and Anthony Robinson [1]

I. INTRODUCTION

Selling goods and services to the Federal Government is an important "lifeline" for many entrepreneurial start-up companies. This is the conclusion of this study which found a strong linkage between the success of young innovative and service-oriented companies and the availability of Federal Government contracts.

When the Federal Government purchases goods and services from the private sector, it also creates a market for new and existing businesses to expand. Once they are established, the young entrepreneurial companies diversify into nonprocurement markets creating additional economic expansion and job opportunities. The net effect of this process is a strengthening of the nation's industrial base—defined as private sector firms that provide goods and services to the Federal Government—and an improved transfer of technology developed for government use to other commercial markets. The fact that high technology spin-off activity has flourished in major centers of government R & D activity—the Silicon Valley and Route 128 are the most noteworthy—suggests that the Federal Government has a potentially powerful mechanism at its disposal for creating jobs, improving technology transfer, and strengthening the industrial base. The Federal Government procurement process is this mechanism.

Nevertheless, it is not difficult to find critics of Federal Government procurement policies. Some groups are outraged by waste and fraud resulting from mismanagement of the contracting process. Others are upset over the Federal Government's "make or buy" policy. They contend that many government officials hide behind unnecessary regulations and red tape to justify in-house provision of goods and services that are available in the private sector at a lower cost. Other groups argue that the procurement system is unnecessarily laden with numerous regulations to achieve nonprocurement goals. These "socioeconomic laws", as they are called, allegedly overburden small business Federal contractors, create inef-

[1] Dr. Premus, a former staff economist with the Joint Economic Committee, is Professor of Economics and Director of the Center for Industrial Studies at Wright State University. Dr. Karns is Director of the Consumer and Business Research Center at Wright State University. Mr. Anthony M. Robinson, Esq., CPA, is with the Office of Private Sector Initiatives, U.S. Small Business Administration, Washington, D.C. Of course, the views expressed in this study are those of the authors and not necessarily the organizations that they represent; nor, do they necessarily represent the view of the Joint Economic Committee, or its Members.

ficiencies in procurement process, and discourage many private sector firms from attempting to sell to the Federal Government.

A number of studies have identified the need to reform the Federal procurement system to make it more efficient. These studies generally call for the Federal Government to: (1) improve the procurement management system, (2) contract out a larger share of its functions, and (3) reduce the number of socioeconomic regulations that the government tries to achieve through the procurement process. Other studies have examined the impact of specific procurement policies and have made recommendations for reform. Many of the "socioeconomic laws", for example, have been the subject of these specialized studies.

One of the major difficulties with studies that call for procurement reform is that they are not based upon a comprehensive analysis of the need to bring about such reforms. A case to get on with procurement reform would be greatly bolstered if a study of the overall procurement process would show that procurement regulations cost the society more than they accomplish.

The purpose of this study is to provide a comprehensive assessment of the impact of socioeconomic regulations on Federal contractor behavior. The study finds no evidence that small businesses significantly modify corporate social policy to be in compliance with socioeconomic laws. The usual case is one in which corporate social policy is already in congruence with the goals and objectives of the socioeconomic laws, making these laws redundant or at least questionable. Nevertheless, evidence was found that the complexity and uncertainty imposed upon the Federal contract market, as a result of the socioeconomic laws, are a significant cost to businesses, the procurement process, and society.

Specifically, considerable evidence was found that socioeconomic regulations complicate an already complicated Federal procurement market and do little to achieve the socioeconomic objectives for which they are intended. One of the side consequences of the socioeconomic regulatory burden is that it diverts the attention of procurement officials away from their primary responsibility—to purchase goods and services from the private sector at the lowest possible price. Another consequence is that private sector firms bear a major opportunity cost in terms of diversion of entrepreneurial resources away from productivity and job enhancing activities to satisfying procurement regulations, which these firms feel are largely redundant.

The organizational structure of the study is as follows: Chapter II reviews the literature of the growth and development of socioeconomic regulations and their relationship to the Federal procurement market. The remaining chapters are devoted to assessing empirical evidence on the impact of socioeconomic regulations on small business behavior, with particular emphasis on the willingness of small businesses to remain in the Federal procurement market.

The analysis is based on a nationwide survey of small businesses that received Federal Government contracts during the years 1979 to 1981. Seven hundred twenty six contractors responded to a survey mailed to approximately 2,530 Federal contractors under a grant from the Small Business Administration. The contractors in-

cluded in the survey were drawn from all sectors of the Federal procurement market, including service, production and research contractors. A copy of the questionnaire can be found in Appendix A of the study.

Multiple mailings were used to achieve the final response rate of 25 percent in the survey. Statistical analysis was performed on the difference between responses of firms which returned the questionnaires promptly and firms that required one or two follow ups or personal letters to respond. For the most part, the analysis did not show any statistically significant differences between the prompt and slow responding contractors. However, the slow responders tended to be more likely to have withdrawn or reduced their Federal contract activity and they were somewhat more negative about their experience in the Federal procurement market.[2] Statistically significant differences between prompt and slow responders will be noted where they occur in the analysis in subsequent chapters.

Chapter III discusses the importance of the Federal contract market to start-up, young, and expanding businesses. A large number of Federal contractors reported that obtaining a Federal contract was significant factor in the start up and early development of their companies. R & D and other service firms were more directly dependent upon Federal contracts than were manufacturing firms. A marked tendency for firms to expand into nonprocurement markets as they grow and mature was also found. This finding suggests that to the extent that the government provides commercial services in house, spinoff jobs to the economy will be sacrificed. Also, to the extent that socioeconomic laws cause procurement management inefficiencies, business participation in the Federal contract market will be discouraged. Besides jobs being lost to the economy, a reluctant vendor community will actually encourage Government in-house provision over market purchase. When this occurs, real costs are imposed on the economy in the form of more costly government services, less job creation, reduced technology transfer, and a weakened industrial base to support the needs of the Government.

Chapter IV looks at the impact of socioeconomic regulations on business behavior to see how effective socioeconomic laws are in achieving social goals. Most businesses were found to make only minor changes in physical structures and work routines to accommodate Federal regulations. This finding provides rather strong evidence that the Federal regulatory bureaucracy is not having a major impact on business behavior in terms of achieving government mandated goals and objectives.

Another indication that the socioeconomic laws are not working was found by examining the employment opportunities for the handicapped segment of the nation's labor market. The creation of greater employment opportunities for the handicapped is, and should be, a major goal of national public policy. However, our study found that few firms have actually extended employment op-

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[2] Firms which were slow in reponding to the survey tended to have the following characteristics: 1) they had been founded more recently than prompt responding firms; 2) they had a slightly lower sales volume; 3) they received compliance orders from more Federal agencies than prompt responders; and 4) they had had contact with fewer Federal Government agencies than prompt responders.

portunities to the handicapped because of Federal contract provisions, *a' la The Rehabilitation Act of 1973.* Many firms voluntarily made the necessary modifications to employ the handicapped because they believe this to be an exercise of corporate responsibility. In general, a major conclusion of Chapter IV is that Federal procurement policies aimed at altering corporate social policies have actually had very little impact, as measured by changes in physical facilities, work routines and employment policies to be in compliance with Federal procurement socioeconomic regulations.

Although Federal contract requirements are apparently having little direct impact on modifying firm behavior, in accordance with Federal goals and regulations, the cost to the regulatory process to contracting firms, and to society, was found to be quite large. This is the major finding discussed in Chapter V. Federal contractors listed the regulatory burden ahead of inflation high interest rates, and competition with large Federal contractors as having the largest negative impact on the growth and development of their businesses.

The main burden associated with the regulatory system was a result of the uncertainty associated with the legal standing of firms regarding the socioeconomic laws. Time spent understanding the procurement process, and dealing with Federal procurement officials who were unfamiliar with the business environment, diverted scarce entrepreneurial resources away from productivity and growth enhancing activities, such as production management, engineering design, and production arrangements. Paperwork was another important cost but in money terms it was not large at the individual firm level. The expenditure of entrepreneurial time and energy was the largest cost factor.

Chapter VI concludes the study with a summary and conclusions. One of the major conclusions of the study is that reforming the Federal procurement system offers a significant opportunity to improve the efficiency of Federal Government procurement, expand the nation's industrial base, improve technology transfer, and create jobs for many Americans. Another major conclusion of the study is that the Federal Government attempt to use the procurement system to achieve the social goals of society is ineffective and costly. Taxpayers, workers, and businesses are losers in the process, but the biggest losers are those individuals and groups who are the intended beneficiaries of socioeconomic regulations. To the extent that imposing socioeconomic laws on the Federal procurement process diverts Congressional and public policy attention away from more effective means of achieving socioeconomic goals, the handicapped, the minorities, small businesses, backward regions, declining industries, and other targeted groups, such as the constructions' trades, are the real losers.

II. FEDERAL PROCUREMENT MARKET AND CONTRACT REGULATIONS: AN OVERVIEW

This chapter provides a discussion of the process by which the Federal Government acquires goods and services from the private sector and the policy issues raised by the procurement process. The purpose of this chapter is to highlight the complexity of the government procurement process caused by the proliferation of nonprocurement regulations imposed upon the process by Congress. Advocates and opponents of using the procurement process to attempt to achieve nonprocurement goals, have created a substantial literature regarding the desirability and effects of Congressional attempts to achieve social and economic goals through tie-in provisions attached to Federal contracts. This literature provides the basis for the major portion of an overview of the procurement process.

The Federal Procurement Market

The Federal procurement market has great significance in the American economy. Of the total U.S. Federal budget, approximately 20 percent is spent on the procurement of goods and services.[1] In Fiscal Year 1982, the Federal Government spent $159 billion to procure goods and services which accounted for approximately 5.2 percent of the gross national product.

The size of the procurement market has made the use of Federal purchasing power appear to be an attractive mechanism to achieve important social and economic goals beyond the procurement of goods and services. This enticement has led Congress to enact numerous laws and regulations that attempt to force firms, who successfully compete for government contracts, to comply with numerous social and economic laws of increasing complexity. For example, there are currently over 4,000 provisions of Federal law and 64,000 pages of regulations affecting procurement.[2] According to the Annual Report on Small Business Administration:

> Potential small business contractors must respond to contract solicitation, which can frequently exceed 100 pages. For example the average solicitation issued by the Department of Defense (DOD) in Fiscal Year 1983 was 84 pages—plus exhibits. Contract solicitations routinely refer to standard form clauses without including the text of such clauses. Consequently, small contractors with limited resources must either research detailed solicitation references themselves or retain expensive, expert counsel.[3]

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[1] *The State of Small Business: A Report of the President Together with the Annual Report on Small Business and Competition of the U.S. Small Business Administration,* United States Government Printing Office, Washington, DC, 1984, p. 315.

[2] Ibid., p. 327.

[3] Ibid., p. 327.

As a result, the Federal procurement market has become highly regulated, encompassing an awesome scope of social goals and regulatory policies. Part of the regulatory burden documented by the Commission on Government Procurement in 1972 were laws and regulations with which Federal contractors must comply to achieve nonprocurement goals.[4]

Despite the 1972 warnings of the Commission of Federal Procurement that "the cumulative effect of programs already imposed on the procurement process and the addition of those contemplated could overburden it to the point of threatening breakdown," [5] the number of contract requirements has continued to rise.

From the viewpoint of a Federal contracting officer, many of these requirements often appear contrary to the government's primary objective of procuring "products and services of the needed quality at the lowest reasonable price available." [6] The numerous other Federal procurement regulations constrain the ability of procurement officials to achieve this objective by requiring compliance with conditions which are unrelated to the good or service procured. One of the hypotheses investigated in the following chapters of this study is that these requirements deter entry into the Federal contract market.

Competitive Problems

While competition is a fundamental tenant of Federal contract policy, numerous exceptions diminish its importance. Governmental procurement policy is presumably based on full and open competition.[7] Like any other buyer, the Government is interested in the widest variety of choices at the lowest possible price. Additionally, as a measure of fairness every qualified seller is, in principle, given the opportunity to compete for government business.

Competition can be based on price, service, or both. Usually people think of competition as the lowest possible price for a particular product. However, few products purchased by government are similar enough to purchase solely on the basis of price. Quality considerations are generally incorporated in the determination of what constitutes the best value. By competing on the basis of quality differences including service, vendors can provide a variety of possible choices to meet a particular need. This increased availability of selection helps to ensure that government expenditures will be made in the most cost-effective basis.

Generally, Federal Government purchases are solicited by formal advertisement. Formal advertisement is designed to solicit offers for a specified product or service from all sellers through publicized Invitations for Bid (IFB). Offers are received and opened at a specified time and location with the award going to the lowest qualified bidder. Barring collusion by bidders, formal advertising is essential to the efficiency of the competitive process.

In lieu of formal advertising, government officials can use negotiation. Negotiated procurement can be either competitive or sole

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[4] United States Commission on Government Procurement, Vol. 1, 1972, p. 114-115.
[5] Ibid., p. 111.
[6] Ibid., p. 122.
[7] 41 USC 401 et seq. (Supp. III 1979).

source (noncompetitive). Negotiated competitive procurement is similar to formal advertising except that factors other than price are considered in awarding the contract. In both sole source and competitive negotiations, the government negotiates the terms, quality, and price. The selection is based on the government's perception of what constitutes the best overall contract.

Negotiation for civilian agencies is based on 15 exceptions to the use of formal advertising.[8] Similar exceptions exist for military procurements.[9] Studies have found that efficiency of the procurement process could be improved if government agencies relied less on sole source procurements and more on competitive bidding.[10]

Another potential barrier to effective procurement competition is the limited number of competitors. As will be discussed, one of the major findings of this study is that many vendors do not find selling to the government an attractive market. As they withdraw from the market they reduce contract market activity. Thus, the government must continually find new vendors to replace those that decide to drop out of the procurement market. It appears that cumulative socioeconomic and administrative burdens placed on contractors is responsible for the decision of many firms to no longer participate in the Federal procurement market.

Theory of Regulation

A recent Annual Report of the Joint Economic Committee characterizes Federal regulatory requirements as economic or social, depending on their scope and purpose.[11] Both types of regulatory activity have a primary characteristic ". . . that the regular seeks the benefits of regulation while avoiding many of the costs. But attaining regulatory goals requires the expenditure of significant public and private resources. The costs of achieving such national goals are borne, in large part by nonfederal actors: State and local government, private businesses and private citizens."[12] Federal regulations attempt to achieve national policy goals while forcing certain actors to bear the costs of achievement.

Economic Regulation

Economic regulation can be viewed as an attempt to control participants in the economic process so that markets function in a so-called "orderly" fashion to correct the effects of possible deficiencies in industry structure such as monopoly. In essence, economic regulation seeks to control the supply of goods and services to the market. Much of such regulation is promulgated under the stated belief that practices such as "cut throat or destructive competition" or "predatory pricing" will lead to market monopolies or market

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[8] 41 USC 252(c).

[9] Under Public Law 98-369, Title VII, Sec. 2701 et. seq., Competition in Contracting Act of 1984 the competitive and noncompetitive connotations associated with "formal advertising" and "negotiation" are eliminated. This law takes effect in 1985.

[10] *Less Sole-Source, More Competition Needed on Federal Civil Agencies Contracting,* PLRD 82-40, U.S. General Accounting Office, Washington, DC, April 7, 1982.

[11] U.S. Congress, Joint Economic Committee, The 1983 Joint Economic Report, Report of the Joint Economic Committee (Washington, DC: Government Printing Office, 1983), pp. 248-254.

[12] Advisory Commission on Intergovernmental Relations, *Regulatory Federalism: Policy, Process, Impact and Reform,* Washington, DC, February 1984, p. 234.

collapse. A major assumption of this view is that the general public will benefit if the costs associated with market deficiencies are shifted to the monopolistic actors who theoretically receive exceptional economic benefits.

Economic regulations are generally targeted toward a single, specific industry or business firm. Formation of the Interstate Commerce Commission in 1881 was an early example of economic regulation which continued to dominate Federal regulatory activity throughout the nineteenth and first sixty years of the twentieth century. During this period, such familiar regulatory agencies as the Civil Aviation Board (CAB), Federal Trade Commission (FTC), Food and Drug Administration (FDA), and bank regulators were established.

Social Regulation

Social regulations are defined more broadly to have effects across broad groups of industries, individuals and businesses. Environmental, occupational and affirmative action requirements are examples of social regulations. The objective of social regulations is generally to force businesses to internalize the costs that their actions impose on society. These social costs appear in the form of polluted air and water, occupational accidents and injuries and insufficient job opportunities for minorities and handicapped workers.

While economic regulations attempt to control the supply of goods and service, social regulation may be viewed as an attempt by organized "public interest" groups to attain benefits for the general public, or may be viewed as a governmental response to reduce the economic consequences of externalities created by the firms.

Capture Theory of Regulation

The original theoretical justification for Federal regulatory policy lay in the arguments of welfare economics that the general welfare would be increased if monopolist rents in noncompetitive industries were reduced. More recent theoretical work by George Stigler and others has shifted the focus away from theoretical arguments to empirical research. As Stigler says, the "central tasks of the theory of economic regulation are to explain who will receive the benefits of burdens or regulation, what form regulation will take, and the effects of regulation on the allocation of resources." [13] He defined the so-called "capture theory of regulation" in saying, "As a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit." [14]

According to the capture theory of regulation, the benefit sought is usually in the form of a subsidy coupled with entry barriers in order to protect the acquired regulatory property rights from competition.[15] A number of studies have documented empirical evi-

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[13] George J. Stigler, *The Citizen and The State*, Chicago: University of Chicago Press, 1975, p. 114.

[14] Ibid.

[15] George J. Stigler, "The Theory of Economic Regulation," *Bell Journal of Economic and Management Science*, Vol. 2, 1971, p. 3.

dence that shows consumers pay higher prices because of economic regulations.[16]

One of the difficulties with the capture theory of regulation is that it does not appear to explain the existence of social regulation. Some economists disagree and argue that, when properly interpreted, the capture theory does apply to social regulations. They contend that it is "public interest groups" which capture the regulatory process and impose their values on the agency and the regulated industry.[17] As will become evident, a central hypothesis of this study is that the supply constraining aspects of economic regulation, and resultant accrual of property rents, is applicable to social regulation, particularly in the Federal procurement market. While the regulated parties may not deliberately seek regulation, they recognize that they can pass the costs back to the government, restrict entry, and increase profitability.

For example, environmentalists might seek to reduce the amount of lead in gasoline below existing levels. Certain producers of gasoline, not able to meet this standard, will be forced out of business. As a result, other firms who meet the standard gain in market share and increased profitability. Thus, while an industry may be generally opposed to certain types of regulations, there may be occasion when tacit acquiescence enhances profitability.[18]

Two recent examples of social regulations are worth noting. In a feature story, the *Washington Post Magazine* reported that Araskog, Chairman of ITT Rand, was lobbying to prevent special exemptions from the Clean Water Act by two wood-pulp mills owned by a competitor. ITT's Rayonier division, which had spent $100 million to process waste products from its plant, argued that any reduction in environmental requirements for a competitor would hurt them competitively.[19]

Maloney and McCormick found evidence to support the view that firms seek to acquire valuable property rights through the imposition of social regulation.[20] Specifically, they found "evidence that a number of firms experienced an increase in value, based on their stock prices, contemporaneously with OSHA plans to restrict cotton-dust levels. Moreover, stock price increases were positively related to the fraction of cotton used by the firms in this production process." [21]

The Cost of Federal Regulations

Murray Weidenbaum estimated that the total cost of Federal regulation in 1979 exceeded $100 billion dollars, including $4.8 bil-

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[16] Richard A. Posner, "Theories of Economic Regulation," *Bell Journal of Economics and Management Science*, Vol. 5, 1974, p. 335.

[17] George J. Stigler, *The Citizen and the State*. See also Richard L. Smith, "Franchise Regulation: An Economic Analysis of State Restrictions on Automobile Distribution," *Journal Law and Economics*, Vol. 25, 1982, p. 125.

[18] For an early historical example of this practice see: Howard P. Marvel, "Factory Regulation: A Reinterpretation of Early English Experience," *Journal of Law and Economics*, Vol. 20, 1977, p. 79.

[19] Walter Shapiro, "Why Mr. ITT Comes to Washington," *The Washington Post Magazine*, August 8, 1982, p. 11.

[20] Michael T. Maloney and Robert E. McCormick, "A Positive Theory of Environmental Quality Regulation," *Journal of Law and Economics*, Vol. 25, p. 39.

[21] Ibid. at 122, see also B. Peter Pashigian, "The Effort of Environmental Regulation on Optional Plant Size and Factor Shares," *Journal of Law and Economics*, Vol. 27, p. 1.

lion of direct expenses by the Federal regulatory agencies.[22] The estimates of total costs in Weidenbaum's study are made up of: (1) the cost of administering the regulatory agencies; (2) the indirect cost of compliance by the private sector; and (3) the induced effects of regulation including effects on innovation, capital formation, and the structure of industry.[23]

According to Edward Denison, regulation accounted for 25 percent of the potential average annual decrease in productivity in the United States. Once firms can no longer live off their capital they fail. Such failures have enormous economic and social costs in their own right.[24]

Increases in the cost of Federal contracts, a restricted vendor supply, diversion of private sector resources, and lessened productivity improvement, are all part of the "hidden tax" of socioeconomic contract regulations.

Federal Procurement Regulations

Firms that sell to the Federal Government are among the most regulated in society. In addition to having to comply with the regulations governing the behavior of all firms in society, they must also comply with procurement market regulations. All Federal contracts and grants are subject to certain regulations designed to ensure that contractors meet minimum qualifications, perform contracted work satisfactorily, and maintain satisfactory records.

Unlike many other markets, the Federal contract market is also laden with numerous laws and regulations that are designed to achieve economic and social objectives apart from the procurement of research, products and services. The regulations governing the Federal contract market generally are characterized as socioeconomic laws, being a blend of economic and social regulations. In addition to the regulatory requirements confronting all businesses in the U.S. economy, Federal contractors are burdened with additional regulations governing entry into the Federal contract market, and their behavior toward specific groups, for example the handicapped, once they are in the market.

The Davis-Bacon Act, the Buy American Act, the Walsh-Healy Act, "set-asides" for small businesses and minorities, and numerous other regulations set requirements for entry into the Federal contract market. There is a paucity of knowledge about the overall impact of these so-called "socioeconomic" laws on the cost structure of businesses, their willingness to compete in the Federal contract market, and whether or not the socioeconomic laws are achieving their objectives.

The Davis-Bacon Act (40 U.S.C. 276a(1)–(5)) enacted in 1931 was an early example of a socioeconomic regulation. It required Federal contractors to pay the prevailing wage rates to workers engaged in construction activity even if labor could be hired at lower wages.

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[22] Murray L. Weidenbaum, *The Costs of Government Regulation of Business*, U.S. Congress, Joint Economic Committee, Washington, DC, 1978, p. 4.

[23] Murray L. Weidenbaum, "The High Cost of Government Regulation," *Challenge*, Vol. 6, 1979, p. 39.

[24] Edward F. Denison, "Explanations of Declining Productivity Growth," *Survey of Current Business*, V., August 1979.

Such a regulation cuts across industries and both the public and private sectors.

A more recent example of a socioeconomic regulation directly affecting the Federal contract market is the Vocational Rehabilitation Act of 1973 (29 U.S.C. 793). Specifically, Sections 503 (contracts) and 504 (grants) require affirmative employment actions regarding handicapped persons. A study conducted by the National Association of Counties found that the Davis-Bacon and Section 504 requirements were the two most burdensome Federal socioeconomic regulations.[25] The Advisory Commission on Intergovernmental Relations clearly identifies the shift in Federal regulations from economic regulations to crosscutting and socioeconomic regulations in the 1960's and 1970's.[26]

Harry R. Van Cleve, Jr., noted that the socioeconomic clauses ". . . in no sense assist the procurement itself or the contract performance, but embody national social, economic and political goals." [27] The simple fact that the Federal contract market is a major factor in the United States economy has made leverage of the procurement process to achieve national goals attractive. "The opportunities lie in the disciplining effect which the Government can exert on its contracts and grantees." [28]

In 1972, the Commission on Government Procurement identified 39 socioeconomic regulations affecting Federal contracts.[29] More recent studies have increased the number to more than 50 distinct socioeconomic contract regulations.[30] A list of socioeconomic regulations and laws prepared by Hampton [31] is included in Appendix B. While the goal of each case may be laudable, the cumulative result has been a conflict of objectives and multiple enforcement authorities.[32] "The procurement process makes the prime contractor a Government agent for social improvement or reform." [33]

As a consequence, inexperienced firms, especially small firms with limited managerial resources, entering the Federal contract market face a significant hurdle in understanding requirements which they must be satisfied. The documented growth of socioeconomic procurement regulations is consistent with the view that the capture theory is applicable to social regulations such as those appended to the Federal procurement market. Successful Federal contractors can be expected to acquiesce to social regulations that limit entry by existing and potential competitors. While excess substantial monopoly profits will invite new entrants into the Federal market, modest monopoly premiums which exceed the regulatory

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[25] Advisory Commission on Intergovernmental Relations, *Regulatory Federalism: Policy, Process, Impact and Reform*, p. 170.

[26] Ibid., p. 97.

[27] Harry R. Van Cleve, Jr., "The Use of Federal Procurement to Achieve National Goals," *Wisconsin Law Journal*, July 1961, p. 567.

[28] Commission on Government Procurement, *National Policies Implemented Through The Procurement Process*, Washington, DC, 1972, p. 111.

[29] Ibid.

[30] National Academy of Public Administration, "Deregulation of Government Management: Federal Procurement, Interim Report," March 1983, Appendix H.

[31] Richard John Hampton, *Achieving Socioeconomic Goals Through the Federal Procurement Process*, Unpublished DBA Dissertation, George Washington University, 1981.

[32] Herbert Roback, "Government Procurement as a Means of Enforcing Social Legislation," *National Contract Management Journal*, January 1972, pp. 13–24.

[33] Ibid., p. 22.

costs to the government vendors, but not sufficient to invite entry, seem quite feasible.

Proposals for Reforming Procurement Regulations

Over the past two decades several governmental bodies, professional organizations, and individuals have called for changes in the Federal procurement regulations. Reform proposals have followed one of two paths: (a) those focusing on the processes employed by Congress and executive agencies in promulgating and administering regulations, and (b) those aimed at alleviating the burden associated with specific regulation or firms.[34]

The importance of the Federal procurement and the detrimental effect of diminished competition and increasing complexity led Congress to act in 1969, by establishing the Commission on Government Procurement mentioned previously.

Declaring it "to be the policy of Congress to promote economy, efficiency, and effectiveness in the procurement of goods, services, and facilities by and for the Executive Branch of the Federal Government, "bill was passed that outlined twelve general ways of achieving this policy.[35] These twelve recommendations were intended as general guidelines for the work of the Commission and not as changes or modifications in existing procurement laws.

The Commission guidelines were as follows:

(1) Policies, procedures, and practices should be established which will require the Government to acquire goods, services, and facilities of the requisite quality and within the time needed at the lowest reasonable cost and using competitive bidding to the maximum extent possible. This formulation takes into account the fact, that present procurement laws require not only cost, but other factors, such as quality and urgency, to be considered in the award of procurement contracts.

(2) The quality, efficiency, economy and performance of Government procurement organizations and personnel should be improved.

(3) Unnecessary overlapping or duplication of procurement activities, and such related activities as contract administration, inspection, et cetera, should be avoided or eliminated.

(4) Unnecessary or redundant requirements placed upon contractors, or upon Federal procurement officials, should be avoided or eliminated.

(5) Gaps, omissions or inconsistencies in procurement laws, regulations, and directives should be identified and brought to the attention of Congress.

(6) Greater uniformity and simplicity in procurement procedures should be achieved whenever appropriate.

(7) The procurement policies and programs of the several departments and agencies should be coordinated wherever possible.

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[34] Advisory Commission on Intergovernmental Relations *Regulatory Federalism: Policy, Process, Impact and Reform*, p. 234.

[35] *An act to establish a Commission on Government Procurement*, Pub. L. No. 91.129, Section 1, 83 Stat. 269, 1969.

(8) Procurement policies and programs should be conformed, whenever appropriate, to other established Government policies and programs.

(9) Possible disruptive effects of Government procurement on particular industries, areas, or occupation should be minimized.

(10) Not only within the Government, but on the part of organizations and individuals doing business with the Government, understanding of Government procurement laws and policies should be improved.

(11) Fair dealing and equitable relationships among the parties in Government contracting should be promoted.

(12) Economy, efficiency, and effectiveness in Government procurement organizations and operations should be promoted by any other means not enumerated in the above. This item makes it clear that the other course of action are not to be construed as limiting the Commission's inquiries and that the Commission may select additional areas deemed significant, relevant, and important.

In addition to these commission guidelines, the conference report (House Report No. 91-468) stressed the need for simplifying procurement regulations.

> The regulations which flow from procurement statutes, other statutes, and policies and programs related to the procurement process, are, in the Comptroller General's words, "voluminous, exceedingly complex and, at times, difficult to apply, and sometimes even to locate" . . . . The need for simplification is particularly stressed in connection with small business, which cannot afford the high-priced legal talent available to big business. This area demands intensive research to determine where simplification can be achieved without sacrificing precision of meaning and guidance to government and business contracting parties.[36]

In its report to the Congress, the Commission on Government Procurement made three recommendations regarding socioeconomic policy. They were:

> Recommendation 43. Establish a comprehensive program for legislative and executive branch re-examination of the full range of social and economic programs applies to the procurement process and the administrative practices followed in their application.
>
> Recommendation 44. Raise to $10,000 the minimum level at which social and economic programs are applied to the procurement process.
>
> Recommendation 45. Consider means to make the costs of implementing social and economic goals through the procurement process more visible.[37]

The Commission's recommendations did not question the value of the various socioeconomic programs, but rather they sought to minimize the disruptive feature of these programs on the procurement process.

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[36] H.R. Rep. No. 91-468, 91st Con., 1st Sess. 6-17, reprinted in (1969) U.S. Code Cong. Ad. News 1365-1366.

[37] Commission on Government Procurement, *National Policies Implemented Through The Procurement Process*, Vol. 1, pp. 118, 120, 122.

Apparently, the Commission's recommendations have gone unheeded. According to a Government Accounting Office report issued in 1978,

> The executive branch announced its acceptance of the Commissions recommendations through the Federal Register in 1976. It further noted the need for joint executive action with the Congress. Since that time, OFPP has discussed the matter informally with members of Congress and key congressional staffers. As yet, congressional support has not been forthcoming. A major problem is that no single committee the Congress has jurisdiction over both procurement and the various socioeconomic programs.
>
> OFPP and most all Federal agencies are in agreement that action to reform the procurement process is needed. The Department of Labor also acknowledged, informally, that socioeconomic dollar level exemptions on Federal contracts should be updated for inflation. The Congress may want OFPP to develop a proposal for joint congressional/executive action on the Commission recommendations. Such a proposal, as a minimum, could cover improved administration of current programs and a means for coordinating and assessing new applications to the procurement process. [38]

More recently, a doctoral dissertation by Richard J. Hampton entitled "Achieving Socio-economic Goals Through the Federal Procurement Process" found that many procurement officials felt that implementation of the Commission's recommendations is infeasible because of methodological difficulties in estimating cost and political reluctance. [39]

While some thresholds for the application of socioeconomic regulations have been increased, Hampton laid the responsibility for little movement in implementing the procedural recommendations of GOGP at the Federal Government's door. According to Hampton,

> The executive and legislative branches are not currently interested in implementing the COGP recommendations. Although Congress increased the threshold for applying the bonding requirements of the Miller Act from $2,000 to $25,000 in apparent support of COGP recommendation A-44, it took this action, in part, to allow more small and minority businesses to obtain bonding if they encounter difficulty in this respect. Moreover, such programs as the Service Contract Act and the 8(a), small, and minority business programs have been expanded. Furthermore, other new programs have been introduced in the areas of inflation, women-owned business, and environment since publication of the COGP recommendations. Congress has also not been receptive to executive testimony in hearings that questioned the use of the procurement process to achieve socioeconomic goals, but that testimony tends to focus on relatively narrow means of implementing individual pro-

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[38] *Legislative Recommendations of the Commission on Government Procurement: 5 years later,* PSAD278-100, U.S. General Accounting Office,, Washington, DC, July 31, 1978, p. 22.

[39] Richard John Hampton, *Achieving Socioeconomic Goals Through the Federal Procurement Process.*

grams. It makes little or no use of in-depth studies to examine the cumulative burdens imposed by all socioeconomic programs. It also exerts little or no effort to determine the cost or appropriateness of using the procurement process to achieve the goals of a single program. Finally, the executive branch has not attempted, for political reasons, to introduce a legislative package that advocates comprehensive implementation of the COGP recommendations.[40]

The General Accounting office has focused on specific substantive reforms including:

(1) Repealing the Davis Bacon Act (recommended in April 1979)

(2) Repealing the Service Contract Act (recommended in January 1983)

(3) Advocating more disciplined procurement practices in the 8(a) Program (October 1982)

(4) Application of higher thresholds for all socioeconomic programs (September 1980).[41]

Carlucci proposed ten major legislative initiatives to reform socioeconomic provisions attached to Defense acquisition processes.[42]

More recently the National Academy of Public Administration undertook the study of deregulation of management focusing on federal procurement. After careful review of good and bad experiences with such provisions, the National Academy recommended four reforms, both substantive and procedural. The reform preferred by the National Academy of Public Administration are as follows:

(1) Raise the threshold for the application of socioeconomic requirements of $25,000 in all cases, and provide for periodic adjustment by the Administrator of OFPP to maintain parity with the small purchase threshold. At least 13 laws or regulations need attention.

(2) Maximum development opportunities with 8(a) firms—minority owned and disadvantaged business—by sharing the more effective procurement practices which have led to mutually advantageous results. OFPP and SBA should publicize such cases as a guide to future procurements.

(3) Charge OMB, SBA and DOL with the continuing search for innovative and more cost-effective practices. Particular study is urged of practices of Government Corporations, grantees, and private companies who voluntarily apply such programs without the rigidity of government regulations. An agenda of eight actions is suggested.

(4) Periodically assess the 52-plus statutes and regulations governing the socioeconomic programs which use the procurement process to determine if legislative revisions are needed to better achieve national goals. The current experience with tax credits by the State of South Carolina bears watching.[43]

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[40] Ibid., p. 242.
[41] National Academy of Public Administration, "Deregulation of Government Management: Federal Procurement, Interim Report," p. 20.
[42] Ibid., p. 18.
[43] Ibid., p. 30.

In considering reform of socioeconomic regulations attached to the Federal procurement process, the reform issues, according to the Panel of the National Academy of Public Administration, are not whether the policy objectives are wrong, but: "(a) whether their method of application is efficient, economical, and cost-effective; (b) whether other means of meeting these objectives might be considered in lieu of contracts; and (c) whether the original means and statutory ground rules need reassessment." [44]

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[44] Ibid., p. 18.

III. FEDERAL PROCUREMENT AND ENTREPRENEURSHIP

The main purpose of this chapter is to provide empirical evidence of a linkage between entrepreneurial activities and the Federal procurement market. Subsequent chapters provide empirical evidence that Federal socioeconomic laws are not working to any significant degree. Costs are not borne by businesses and social goals are not being realized, according to the evidence provided. Many firms are not willing to sell to the Federal Government because of the complexity of contract regulations, but profit margins are reported to be adequate by a large percent of those firms that have remained in the Federal contract market. This suggests that the Federal Government bears the cost of social regulations. The empirical evidence presented in this and subsequent chapters is based upon a 1981 survey of 712 small business Federal contractors.

Federal contracts were found to be crucial to the start up and early expansion of a large percent of the small businesses that participated in the Wright State University survey. The study found that as these firms grow and mature, they diversify into other nonprocurement, or commercial, markets. The survey evidence shows that older firms in the sample are significantly less reliant than the younger firms on the procurement market for total sales.

The tendency for Federal contractors to diversify into other commercial markets as they grow and mature is important to the overall efficiency of the procurement process. In particular, it strengthens and broadens the nation's industrial base upon which the Federal Government depends for goods and services that it procures. To the extent that the procurement market stimulates other entrepreneurial activities, the nation and its regions benefit from additional jobs, technology transfer, and economic expansion.

The Importance of Federal Contracts in Starting Businesses

A review of the survey responses of small business Federal contractors shows that Federal contracts play an important role in the start-up of young, entrepreneurial companies. According to Table 3.1, nearly 20 percent of the respondents indicated that Federal contracts were essential to their starting a business. Another 26 percent indicated that contracts were "very important or important" in starting their business. Another 14 percent of the respondents indicated that obtaining a Federal contract was at least "somewhat" important in the start up of their business. Thus, Federal contracts appear to play a role in the start up of approximately 60 percent of all the firms in the Wright State University survey.

TABLE 3.1—IMPORTANCE OF FEDERAL CONTRACTS IN STARTING A BUSINESS

Degree of importance	Percentage
Essential	19.6
Very important	15.9
Important	10.3
Somewhat important	13.8
Not important	40.4
Total	100.0
Weighted cases	704

The importance of the Federal contract market to entrepreneurial activities is related to the difficulty many firms have in obtaining early stage financing. In particular, the flow of cash and profits associated with Federal contracts provides an alternative source of capital for the operation of a business in its early years of operation. Many small businesses are actually supported by retained earnings rather than by equity participation by stockholders or by commercial bank loans. Access to Federal contracts can provide a stream of income once the Federal contract process has been successfully penetrated. Unfortunately, as will be shown later, the regulatory burden associated with entry and involvement in the Federal contract market does act as a significant barrier to entry of small businesses. However, this market also apparently provides an important source of start-up financing for Federal Government contractors.

Evidently, the Federal contract market has been more of a "boon" to entrepreneurial activities in recent years. According to Table 3.2, there is a significant difference in the importance of Federal contracts in starting a business for younger firms than for older firms. More than 40 percent of all firms born between 1971 and 1975 and 45 percent of the firms born between 1976 and 1981 indicated that Federal contracts have been "essential or very important" in starting their business. For the youngest group of firms in the survey—those born between 1974 and 1981, approximately 69 percent indicated that a Federal contract was either essential, very important, important, or somewhat unimportant in starting their business. Only 31 percent of the youngest firms indicated that Federal contracts played no role in starting their business. In contrast, 58, 49, 47 and 35 percent of the firms born before 1940, between 1941 and 1960, between 1961 and 1970 and between 1971 and 1975, respectively, found Federal contracts to be of no significant assistance in starting their business. One-half of the firms in the survey indicated that government contracts were at least important in the founding of their business.

TABLE 3.2—IMPORTANCE OF FEDERAL CONTRACTS IN START-UP DECISION BY AGE OF FIRM

Degree of importance	Year of company founding				
	Before 1940	1941–60	1961–70	1971–75	1976–81
Essential (percent)	0.9	11.2	16.4	24.2	11.8
Very important (percent)	35.5	9.7	10.6	16.5	33.6
Important (percent)	4.2	11.1	10.9	8.7	7.6
Somewhat important (percent)	1.2	18.8	14.8	15.3	16.0
Not important (percent)	58.3	49.3	47.3	35.2	31.1
Total (percent)	100.1	100.1	100.0	99.9	100.1
Weighted cases	19	117	138	137	84

On the other hand, as one might expect, the importance of Federal contracts to entrepreneurial activities is not uniformly distributed across different types of contracts. Research firms show the most dependence on Federal contracts for start-up financing, followed by service and production firms in that order. According to Table 3.3, 42 percent of the firms that received a research contract indicated that the contract(s) was essential to their company's founding, in contrast to 22 percent and 14 percent for those firms that received service and production contracts, respectively. More generally, about 66 percent of all responding firms that obtained a research contract indicated that Federal contracts were essential, very important, important, or somewhat important in the beginning of their operation. In contrast, about one-half of service firms and fewer than 33 percent of the production firms indicated that Federal contracts were at least somewhat important in starting their firms.

TABLE 3.3—IMPORTANCE OF FEDERAL CONTRACTS IN STARTING BUSINESS BY TYPE OF CONTRACT

Degree of importance	Contract category		Research	Service
	Combination	Production		
Essential (percent)	19.7	14.2	41.9	22.2
Very important (percent)	37.2	9.1	13.1	17.9
Important (percent)	12.8	8.7	12.5	11.0
Somewhat important (percent)	4.5	17.8	6.4	13.1
Not important (percent)	25.8	50.2	26.1	35.8
Total (percent)	100.0	10.0	100.0	100.0
Weighted cases	56	257	19	362

The tendency for research and service-oriented firms to be more dependent on Federal contracts for start-up decisions than manufacturing firms is an important finding. The high technology and service sector have been a major source of technological innovation and job expansion in the United States.[1] To the extent that it is

[1] Robert Z. Lawrence, *Changes in U.S. Industrial Structure: the Role of Global Forces, Secular Trends and Transitory Cycles*, Prepared for Federal Reserve Bank of Kansas City Symposium on Industrial Change and Public Policy, Jackson Lake Lodge, Wyoming, August 25–26, 1983; and Robert Premus, *Location of High Technology Firms and Regional Economic Development*, A staff study prepared for the Joint Economic Committee, U.S. Congress, Washington, D.C. June, 1982.

encouraging the development of innovative companies, the Federal procurement market is an important part of the growth dynamics of the American economy. Finally, Federal contracts contributed to the company formation decision of those businesses that currently have the smallest annual sales volume. As Table 3.4 indicates, more than one-half of the firms under $500,000 in annual sales, described Federal contracts as being essential or of some degree of importance to the starting of their business. This finding is consistent with the finding discussed earlier that the procurement market was more important to the start up of younger firms in the sample than it was for the older firms, since younger firms tend, also, to be smaller firms. In general, the survey results of the section confirm the view of many that entrepreneurial activities in the dynamic sectors of the economy benefit the most from Federal procurement policies. Newly formed, small businesses involved in research were found to be the most dependent on Federal contracts for start up and early expansion.

TABLE 3.4—IMPORTANCE OF FEDERAL CONTRACTS IN STARTING BUSINESS BY ANNUAL SALES

Degree of importance	Annual sales			
	Under $500,000	$500,000–$1,500,000	$1,500,000–$3,500,000	Over $3,500,000
Essential (percent)	18.9	21.6	11.8	11.2
Very important (percent)	20.8	13.0	7.5	26.8
Important (percent)	13.9	8.7	9.6	7.7
Somewhat important (percent)	16.9	17.2	19.3	10.9
Not important (percent)	29.4	39.4	51.9	43.4
Total (percent)	100.0	100.0	100.0	100.0
Weighted cases	103	122	114	116

The shift in Federal procurement to the more technologically sophisticated goods and services throughout the 1960's and 1970's probably accounts for the greater dependence of start-up activity on Federal contracts in more recent years. As a result, it would appear that by stimulating the growth and expansion of young innovative firms, Federal procurement policy is having an increasingly important impact on growth of productivity in the United States. It also implies that Federal procurement regulations, to the extent that they discourage these firms—voluntarily or involuntarily—from participating in the Federal contract market, can negatively impact entrepreneurial activities and technological change. To the extent that this occurs, the economy is denied the benefits of jobs and economic growth associated with entrepreneurial activities in the research, service and production sectors that could arise from firms providing goods and services to the Federal Government.

Federal Contracts as a Percent of Total Annual Sales

The importance of Federal procurement to the economy is magnified to the extent that the new start-up companies expand and diversify (or "spin-off") into nonprocurement, or commercial markets. The degree of commercial "spin-off" activity from the Federal

procurement market can be measured, at least indirectly, by examining the relative importance of Federal contracts to total annual sales at various stages of firm development. The tendency of firms to become less dependent of Federal contracts for sales over time would indicate that they are diversifying into other commercial markets.

As discussed in the previous section, newly founded research and service-oriented firms show a greater dependence on the Federal contract market as a source of start-up financing. According to Table 3.5, the percent of firms that receive 50 percent or more of their annual sales revenue from Federal contracts declines with the age of the firm. About 30 percent of the firms born after January 1, 1976, received greater than 50 percent of their annual revenue from Federal contracts. Of the companies founded between January 1, 1971, and December 31, 1975, 26 percent reported revenue for sales to the Federal Government in excess of 50 percent of total firm revenue. In contract, only 16 percent of the firms born between January 1, 1961, and December 31, 1970, and only 12 percent of firms born between January 1, 1941, and December 31, 1960, depend on Federal contracts for 50 percent or more of their annual revenue. In general, the proportion of firms born after 1980 receiving 50 percent or more of their revenue from the Federal contract market is about twice as high as it is for firms born before 1940.

TABLE 3.5—PERCENT OF FIRMS RECEIVING FIFTY PERCENT OR MORE OF THEIR CURRENT ANNUAL SALES FROM FEDERAL CONTRACTS, BY AGE OF FIRM

	Percent of annual sales
Year of company founding—	
1976 to 1981	29.4
1971 to 1975	26.2
1961 to 1970	15.6
1941 to 1960	12.3
Before 1940	15.0
Total	98.5

Only 60 firms that responded to the survey questions on the relationship of Federal contracts to total sales reported that they received 75 percent or more of annual revenue from Federal contracts. Of this group, 39 were born after 1975 and 51 were born after 1970. Only nine of the firms born prior to 1970 showed this degree of dependence on Federal contracts for total sales. This finding adds additional support to the view that firms become less dependent on Federal contracts as they expand and diversify into other nonprocurement related commercial markets.

The empirical results of the study are consistent with earlier studies by Rothwell and Zegveld [2] and Roberts and Wainer.[3] These

[2] Roy Rothwell and Walter Zegveld, *Industrial Innovation and Public Policy* (London, England: Frances Pinter Publishers, Ltd., 1981).

[3] Edward B. Roberts and H.A. Wainer, "New Enterprises on Route 128," *Science Journal* (December, 1968).

studies show a marked tendency of Federal contractors to diversify into other commercial markets as their firms grow and expand. The result of this type of diversification is that firm dependence upon Federal contracts for sales diminishes with the age of the firm.

The disaggregation of Federal contractor firms that receive 50 percent or more of their revenue from Federal contracts into contract categories is also quite revealing. Table 3.6 shows that, of the research, manufacturing, high-technology and service-oriented firms in the survey, the high technology firms and related research firms are much more dependent than manufacturing and service firms on Federal contracts for total sales. Over 25 percent of the high-technology and research firms currently receive 50 percent more of their total annual sales from Federal contracts, in comparison with 16 percent and 19 percent for the manufacturing and service firms, respectively.

TABLE 3.6—PERCENT OF FIRMS CLASSIFIED BY TYPE THAT RECEIVE 50 PERCENT OR MORE OF THEIR CURRENT ANNUAL SALES FROM FEDERAL CONTRACTS

Type of firms	Percent of firms
High technology	26.4
Research	25.4
Service	19.1
Manufacturing	16.4
Total	87.3

As these research and high-technology companies grow and expand into nonprocurement markets, the economy benefits from improved technological innovation. The net result of this process of interaction is better quality products and technologies available to the Federal Government, an expanded and strengthened industrial base, and greater employment opportunities outside of the procurement market. The regional effects can also be quite large. Studies have shown that the emergence of the worlds two leading high technology centers—the Silicon Valley in the San Francisco Bay area and Route 128 in Boston, owes much to the ability of firms in these regions to obtain Federal R&D contracts, suggesting that the "spin off" generating benefits can be quite substantial.[4]

Summary

This chapter provides substantial evidence of a strong connection between the Federal contract market and the start up and development of innovative research and service-oriented firms. It also finds substantial evidence that firms selling to the Federal Government diversify into commercial markets as they grow and mature.

These research findings have important implications for public policy. First of all, they suggest that, to the extent that the Federal Government can procure resources externally, the economy bene-

[4] Premus, op. cit., Appendix A. Also, see Edward J. Malecki, Testimony before the Joint Economic Committee Hearing on Government Labs, Washington, D.C., August 7, 1984.

fits from technological innovation, economic expansion and job creation. The growth of commerical markets, in turn, can be very important to enhancing and improving the technology and goods and services available to the Federal Government through contracting out. The electronics, aerospace and computer industries, for example, owe much of their initial success to Federal Government procurement policies. These industries are now supplying new and improved products and service to the Federal Government and contributing greatly to the strength of the American economy. The Silicon Valley and Route 128 developments, as previously discussed, attest to mutually beneficial effects of "spin-off" activities from Federal Government procurement policies on regional economics. Also, to the extent that technology developed by private firms under Federal Government contract is transferred to firms in non-procurement markets, additional gains in productivity and job creation to the American economy are realized.

IV. THE BENEFITS OF SOCIOECONOMIC LAWS

An important consideration in evaluating the effectiveness of achieving social goals through the Federal procurement market is the extent to which the goals are actually being realized. One of the most difficult barriers to surmount in evaluating the benefit side of socioeconomic laws, however, is the paucity of data and studies on the benefits of socioeconomic programs. This study, like other studies on this subject, was unable to fully estimate the value of such benefits, but substantial evidence was obtained which indicates that attempts of the Federal Government to achieve social goals through the Federal procurement market are largely ineffective.

This chapter examines the extent to which small businesses selling goods and services to the Federal Government change their corporate social policy to be in compliance with the socioeconomic laws appended to their procurement contracts. Socioeconomic laws such as the promotion of the health and welfare of workers, equal employment opportunities, environmental conditions, and hiring and promotion practices, if they are having any effect, ought to be reflected at the firm level in changes in physical facilities, work routines, and hiring practices.

A major finding of the chapter is that the majority of firms make no changes in work routines, physical facilities, and hiring practices to be in compliance with Federal socioeconomic regulations. Many firms in the survey indicated that they made changes in these aspects of their organizations, but they indicated that the changes were usually made to be in compliance with corporate social policy, without regard to the socioeconomic provisions of Federal contracts. Morever, the dollar outlays by the firms that made changes were small in most cases.

The main conclusion of the analysis is that socioeconomic laws are not working to bring about significant changes in corporate social policy. Most firms are either unaware of the socioeconomic regulations or they feel that they are already in compliance, making these laws unneccessary and redundant. While the evidence that is presented is certainly not conclusive, it nonetheless is substantial enough to raise serious questions about the wisdom of the numerous Congressional attempts to use Federal purchasing power to achieve social goals and objectives.

Work Routines and Physical Facility Changes

The respondents to the Wright State University survey were asked whether they had voluntarily or involuntarily made any major changes in work routines or physical facilities because of the contract requirements of any Federal Government agency. The vast majority of contractors indicated that they made no major

changes. Approximately 48 percent of the Federal contractors were in this category. Only 16 percent of the contractors in the survey, indicated that they had made a change in work routines or facilities, or both (See Table 4.1).

TABLE 4.1—PERCENT OF FIRMS THAT MADE MAJOR CHANGES IN WORK ROUTINES AND/OR PHYSICAL FACILITIES TO COMPLY WITH FEDERAL GOVERNMENT EMPLOYMENT AND WORKING REQUIREMENTS

Types of changes	Percentage of firms
Major changes in work routine	4.4
Physical facilities changes	5.1
Both	6.7
No major changes	83.8
Total	100.0
Weighted cases	669

The most frequent types of work routine changes included changes in operating hours, hiring practices, promotion policies, equal employment opportunity programs, and shop operating procedures. The Federal Government agencies that were most responsible for these modifications were the Department of Labor, the Occupational Safety and Health Administration, and the Equal Employment Opportunity Commission.

While most contractors did not report significant changes in work routines, of the firms that did, 10 percent indicated the work requirement changes had cost them less than $500. Slightly over 33 percent said that the changes had cost them between $500 and $2,500. More than one-half said that the changes had cost more than $2,500. In addition, three-quarters of the respondents who reported work-related changes said that the changes had increased annual operating costs. Slightly more than one-half of these firms indicated that the annual changes were costing them more than $5,000.

For firms that made physical facility changes, structural changes were reported by 40 percent of the responding contractors and the purchase of new equipment was reported by 33 percent of the contractors who had been asked to make the changes. The vast majority of the changes in physical facilities were required by the Occupational Safety and Health Administration. Changes in physical facilities tended to be substantially more expensive than the direct cost associated with work requirement changes. Approximately 76 percent of the contractors that were required to make physical facility changes reported that these changes cost over $5,000. About 63 percent reported that their annual operating costs had also been increased by physical facility changes that they made. Of those firms that reported that their annual operating cost had also been increased by the changes, 70 percent indicated that the annual change increased their cost by more than $500.

In general, the average cost of complying with Federal regulations declined with the length of time that a business had been operating. Businesses that were founded before 1961 reported sub-

stantially higher average costs both for implementation of work rules, and physical facility changes, as well as a greater increase in annual operating costs. Firms that have been established since 1975 reported the least cost associated with these regulations. The finding that newer firms are able to accommodate these structural changes more easily is hardly surprising. Changes are easier to incorporate into new facilities and operations than are modifications of existing facilities and operations.

Accommodations for the Handicapped

Few Americans will disagree that improving job opportunities for those with physical and mental handicaps is an important social obligation of the Federal Government. In principle, finding ways to integrate the handicapped into the mainstream of America's labor market has been given a major boost by the Rehabilitation Act of 1973. This Act extends to the handicapped the same equal employment opportunity protection with regard to Federal grants and contracts provided to minorities and other groups. In addition, the Rehabilitation Act mandates that all businesses receiving Federal contracts of $2,500, or more, must, at their own expense, provide "reasonable accommodation" to recruit and employ the handicapped. The extent to which the Rehabilitation Act is working is an important concern of all of those who want to bring the fruits of America's free enterprise system to handicapped Americans.

Whether or not the Rehabilitation Act is working depends upon the extent to which the intent of the law is communicated to Federal contractors through the procurement bureaucracy, businesses make accommodations for the handicapped, and businesses modify their hiring and promotion policies to employ more of the handicapped.

The Wright State University survey provides evidence that businesses in the Federal contract market are not aware of their social obligations under Federal law (Table 4.2). For example, when asked if they understood their obligations to the handicapped under the "reasonable accommodation" clause of the Rehabilitation Act, about 47 percent of the firms responded that they were "less than confident" or that they knew nothing about reasonable accommodation. Another 32 percent responded that they had some knowledge of the meaning of reasonable accommodation, but they indicated that they were only "somewhat confident" of their own standing. Only 9 percent of the firms indicated that they were "confident" of their understanding of the law, and another 12 percent indicated that they were "very confident".

TABLE 4.2—CONTRACTOR CONFIDENCE IN UNDERSTANDING REASONABLE ACCOMMODATION FOR HANDICAPPED EMPLOYEES

Degree of confidence	Percentage of firms
Fully confident	9.3
Very confident	11.7
Somewhat confident	31.6
Less than confident	14.7
Not meaningful	32.7
Total	100.0
Weighted cases	688

The major implication of these findings is that merely appending a new requirement to Federal contracts is no guarantee that Federal contractors will learn about the requirements through pre-bid conferences with government contract managers or through their contacts with other procurement officials. This finding should be sobering for those who look to the passage of new Federal contract regulations as a quick and easy way to implement social policies.

Nonetheless, regulations appended to a Federal contract may ultimately influence corporate social policy. To ascertain the degree to which this may have occurred, the respondents were asked if they undertook any of the following actions to accommodate the handicapped:

1. Job restructuring-examples include flexitime for workers of grouping physically demanding job tasks within a new job description.
2. Physical facility modifications-examples include wheelchair ramps, accessible bathrooms, teletype machines, amplifying telephones, variable height work stations, devices for reaching or gripping, and air conditioning.
3. Special employee support services-examples include personal assistants, pooled transportation to and from home, and counseling.
4. Specialized training-examples include special orientation to the work site and training supervisors and other employees to adjust to the handicapped.
5. Office modifications-examples include physical modifications, setting up an office in an accessible location, training employment counselors, and seeking qualified handicapped applicants through handicapped organizations.

A significant number of firms indicated that they took one or more of these steps to accommodate the handicapped, but the vast majority of the firms indicated that they undertook these actions on a voluntary basis.

Table 4.3 demonstrates the extent to which firms in the sample undertook actions of various types to accommodate the physically and mentally handicapped, and whether these actions were taken voluntarily or to comply with Federal regulations. In at least 75 percent of the cases, the firms indicated that no actions were undertaken to accommodate the handicapped, voluntarily or involuntarily.

TABLE 4.3—PERCENT OF FIRMS THAT UNDERTOOK ACTIONS TO ACCOMMODATE HANDICAPPED EMPLOYEES

[In percent]

Accommodation	Done to comply with regulations	Done but not to comply with regulations	No change
Job restructuring	2.4	16.4	74.4
Physical facilities	8.2	14.5	70.7
Employee support services	0.6	8.6	85.2
Training	3.0	12.2	75.7
Employee office	1.3	5.3	92.3

Less than 20 percent of the firms indicated that they took one or more of the actions to accommodate the handicapped, but of this small group the vast majority indicated that they undertook these actions as a matter of corporate social policy, not to be in compliance with Federal laws.

The most frequent types of accommodations were job restructuring, changes in physical facilities, and job training programs for the handicapped.

Perhaps the most significant finding is that only a small percentage of the firms undertook actions to accommodate the handicapped, and of those that did, the greatest percentage did so voluntarily. For example, 22.7 percent of the firms indicated that they modified their physical facilities to accommodate the handicapped workers, but 14.7 percent of the total group said they did so in the ordinary course of their business. Only 8.2 percent of the total sample indicated that they made these changes to comply with Federal regulations. Federal legislation had an even smaller impact on the other types of accommodation such as job restructuring, employee support services, job training, and office modifications.

Even more striking is the evidence presented in Table 4.4 which demonstrates that the overwhelming majority of Federal small business contractors have *not* modified their corporate social policy to comply with equal opportunity requirements. Fewer than one-fifth of the responding contractors have undertaken any of six changes affecting employment and promotion practices for handicapped persons or veterans. Even when the scope of employees affected is expanded beyond the handicapped and veterans to other protected classes, not more than one-quarter of the responding contractors have changed employment practices to comply with equal opportunity requirements.

TABLE 4.4—CHANGES IN WORK PRACTICES MADE BY CONTRACTORS TO COMPLY WITH EQUAL OPPORTUNITY REQUIREMENTS

[In percent]

Type of change	Veterans and handicapped		Other employees	
	Yes	No	Yes	No
Hiring changes	21.5	78.5	26.4	73.6
Recruitment changes	17.0	83.0	21.2	78.8
Training changes	10.4	89.6	14.5	85.5
Promotion changes	9.0	91.0	13.5	86.5
Insurance changes	7.1	92.9	8.3	91.7
Layoff changes	6.1	93.9	9.2	90.8

The evidence of the extent to which socioeconomic laws are working, or not working, is quite telling. Federal legislation has done little to influence corporate social policy, according the research findings presented in this study. In fact, the evidence apparently indicates that corporate social policy has changed in response to the same general changes in societal attitudes and priorities that lead to the enactment of the socioeconomic procurement laws in Congress, making their passage seem redundant.

Employment of the Handicapped

The ultimate test of whether or not the Rehabilitation Act is working is the extent to which its passage has resulted in more jobs being available to the nation's handicapped citizens. Table 4.5 list the various types of physical and mental handicaps. It also presents the percent of firms in the sample that had one or more employees with any of these types of handicaps. Heart problems, impaired hearing, impaired mobility, impaired vision, and learning disabilities were the most frequently cited types of handicaps. It is noteworthy to note that the majority of firms, 56 percent, reported that they had a labor force without any of these handicaps, at least to a significant degree.

TABLE 4.5—PERCENT OF FIRMS THAT EMPLOY HANDICAPPED WORKERS BY TYPE OF PHYSICAL AND MENTAL IMPAIRMENTS

Type of impairment	Percent of responding firms
Impaired vision	12.9
Impaired hearing	18.3
Impaired mobility	14.3
Nervous system disorder	5.0
Learning disability	11.8
Heart problems	18.0
Lost limb(s)	5.8
Multiple handicaps	4.5

The central question in the analysis is the extent to which the corporations in the survey increased their employment of individuals with one or more of these handicaps as a result of the Rehabilitation Act. On this score, the results are not encouraging to those who want to use the Federal procurement market to achieve social goals. As Table 4.6 indicates, only 1.2 percent of the firms

indicated that they "increased or greatly increased" employment of the handicapped to be in compliance with Federal contract requirements. Another 4.1 percent said that their firm experienced a "slight increase" in handicapped employment in response to the Federal laws. A vast majority of the firms, 94.2 percent, indicated that the employment of the handicapped was not affected at all by these Federal laws.

TABLE 4.6—IMPACT OF THE REHABILITATION ACT ON EMPLOYMENT OPPORTUNITIES FOR THE HANDICAPPED

Employment opportunities for handicapped	Percentage of firms
Increased	1.2
Slightly increased	4.1
No change	94.2
Slightly decreased	0.4
Total	100.0
Weighted cases	559

The majority of contractors felt that persons with a wide range of physical and mental handicaps are employable in their firms. In fact, the only severely disqualifying handicap presented in Table 4.7 is impaired vision. The perception of contractors varied by type of contract. Service contractors and production contractors were more likely to feel that handicaps related to machine danger and heavy loads disqualify persons from employment.

TABLE 4.7—CONTRACTOR PERCEPTIONS ABOUT THE EMPLOYABILITY OF PERSONS WITH VARIOUS HANDICAPS

Handicap	Employable percent	Unemployable percent	Reasons for unemployability
Cancer history	89.9	10.1	Insurance.
Amputee	64.6	35.4	Heavy loads. Machine danger. Special equipment.
Heart illness history	63.7	36.3	Heavy loads. Stress. Machine danger.
Impaired hearing	63.2	36.8	Machine danger. Special equipment.
Epilepsy	60.8	39.2	Machine danger.
Alcohol abuse history	60.5	39.5	Machine danger. Stress. Need supervision. Interfere with others.
Mental illness history	56.6	43.4	Stress. Need supervision. Machine danger.
Drug abuse history	47.0	53.0	Machine danger. Need supervision. Interfere with others. Stress.
Mobility limitations	46.7	53.3	Heavy loads. Machine danger. Inaccessibility. Special equipment.
Impaired vision	19.5	80.5	Machine danger. Special equipment. Need supervision.

The major reasons advanced for the feeling that persons with specific handicaps are unemployable were within the boundaries of "reasonable accommodation" as used by the Office of Federal Contract Compliance Programs (OFCCP) in the Department of Labor, which has responsibility for enforcing the Section 503 requirements. Thus, it would appear that no systematic bias against firing the handicapped is present in the Federal procurement market.

Summary and Implications

The research findings of this chapter are not encouraging to those who wish to use the Federal procurement market as a mechanism to carry out Federal social policy. The extent to which firms change work routines, physical facilities and other aspects of their organization to be in compliance with Federal laws and priorities and found to be minimal.

Likewise, an examination of Federal contractor experience with the Rehabilitation Act suggests that the procurement mechanism is doing very little to achieve more job opportunities for the handicapped. Only a relatively small percent of the contractors made changes in their hiring polices, work routines, or physical facilities to accommodate the handicapped. An even smaller percentage of the total number of firms in the sample actually increased their employment opportunities for handicapped citizens as a result of the procurement laws.

As discussed in Chapter II, the Federal Government is attempting to achieve over 50 socioeconomic goals by appending legislative directives to Federal procurement contracts. While an examination of how each of these socioeconomic laws are working is well beyond the scope of this study, the evidence regarding health, safety working conditions, and job opportunity for the handicapped is not encouraging. The goals singled out in the study for examination are some of the most sensitive and generally accepted goals of Government. The fact that evidence has been provided that the procurement market is an ineffective mechanism for achieving these goals raises questions about the efficacy of other socioeconomic regulations as well. Certainly, it places the burden of proof that these laws are achieving their purpose on those who would continue to perpetuate the current procurement system by resisting changes in its socioeconomic provisions.

V. THE COST OF SOCIOECONOMIC REGULATIONS

An important factor in the evaluation of socioeconomic laws in the procurement market is the cost imposed by these regulations on businesses selling goods and services to the Federal Government. This chapter examines the nature of these costs and their impact on contractor willingness to remain in the Federal contract market.

The main finding is that the socioeconomic regulations impose a significant cost on business contractors. Contracting firms experience these costs principally in the form of a diversion of scarce entrepreneurial resources away form more productive uses. To the extent that this occurs, the Federal procurement process can be expected to produce fewer commercial (spin-off) activities. The dollar costs were found to be largely passed onto the Government because a majority of firms reported adequate profit margins in selling to the Government. Most firms also expressed a willingness to continue to sell to the Government in spite of the high cost of regulation. In fact, consistent with "capture theory," a few firms felt that the regulations provided a benefit in that they protect the firm's niche in the Federal procurement market by discouraging other firms who might other wise enter as competitive bidders.

Regulatory Burdens

That the regulatory burden is perceived to be quite high is evident in Table 5.1. Firms listed the regulatory burden to be more important than three other common problems confronting the small business community: Inflation, taxation, and competition with larger businesses in the Federal contract market. Designation of the regulatory burden as the most significant problem for small businesses is a remarkable finding given the fact that the nation was experiencing double-digit inflation and interest rates at the time of the survey. Inflation was forcing businesses into a higher tax bracket, thereby, substantially increasing their effective tax rates at this time as well. The fact that the firms listed the regulatory burden as being more important to them at this time indicates that they have very strong feelings concerning the burden of procurement regulations.

TABLE 5.1—RELATIVE IMPORTANCE OF THE REGULATORY BURDEN AS A BUSINESS PROBLEM CONFRONTING SMALL BUSINESS FEDERAL CONTRACTORS

Type of problems	Percent highest rating [1]
Federal regulations	30.7
Inflation	29.1
Competition with large business	25.2
Taxation	19.7
Total	104.7

[1] Percentages add to more than 100 percent because some respondents assigned rank 1 to more than one problem.

A firm's perception of the regulatory burden prior to entering the contract market also had an effect on relative ranking of the business problems. Many firms that expected that the regulatory burden would be significant before they entered the market, actually reported that it was even greater than expected after entering the market. Also, firms with the greatest expectation represented the largest segment of the sample that felt that the regulatory burden was excessive. Finally, those firms that experienced slower sales growth felt that the regulatory burden was larger than average.

As might be expected, the relative rating of business problems varies by the various types of firms and Federal contracts. Table 5.2 lists the four business problems confronting the small business Federal contractor and the percentage responses by type of Federal contract received. Firms that received research contracts in the sample listed competition with large businesses for Federal Government contracts as their most important problem. Over 33 percent of the research firms felt that competition with the large firms in the market for research contracts was the number one problem. Inflation for this group of firms was listed as the number two problem, with 27.8 percent of the research firms reporting inflation as their number one problem. The regulatory burden was rated a significantly lower third by research firms, followed closely by taxation as the most significant problem as measured by the percent of firms rating these problems number one.

TABLE 5.2—RELATIVE RATING OF IMPORTANCE OF BUSINESS PROBLEMS OF FIRMS BY TYPE OF FEDERAL CONTRACT

[In percent]

Types of problems	Type of contract [1]		Production
	Research	Service	
Taxation	20.8	19.5	18.5
Competition with large business	33.9	25.8	24.0
Inflation	27.8	27.8	31.5
Federal regulations	21.1	32.1	29.8
Total	103.6	105.2	103.8

[1] Percentages add to more than 100 percent because some respondents assigned rank 1 to more than one problem.

Firms receiving service contracts perceived the regulatory burden to be the largest problem. Over 32 percent of firms receiving service contracts listed the regulatory burden as their top problem. Inflation was listed as the number one problem by 27.8 percent of these firms, followed by competition with larger businesses and taxation.

Production firms were most influenced by inflation. Over 31 percent of those firms receiving production contracts designated inflation as the top problem Federal Government regulations were listed as the top problem by 29.8 percent of firms receiving production contracts. Competition with other firms received top ranking by 24 percent of this group of firms and the tax burden was listed by 18.5 percent of these firms as their number one problem.

The finding that the regulatory burden was ranked highest by the largest percentage of firms, particularly service-oriented firms and production firms, is the most relevant finding in the survey for this study. Rating regulation higher than inflation and taxation, which are interrelated during inflationary times, provides strong evidence that the regulatory burden is perceived to be a large problem by small business Federal contractors.

Part of the cost which results from contract regulations involves the cost of administering paperwork associated with bids and reports. Another component in contract regulation costs is the cost of adapting work routines and employment environments to satisfy Federal requirements. For example, accommodation of handicapped employees, as required by Section 503 of the Rehabilitation Act of 1973, could mean changing job descriptions and responsibilities so a handicapped person could be employed. Alternatively, accommodation could involve installation of barrier free restrooms or other physical facility change.

More than one out of six contractors reported major modifications in work routines and physical facilities to comply with Federal contract regulations. Contractors who have modified work routines or physical facilities were also asked to estimate the proportion of modification expense that is due to new equipment, managerial time, employee time, outside contractors, and other costs (Table 5.3). While these estimates are subjective, they accurately reflect contractors' perceptions of the relative components of regulatory costs. Insofar as subjective costs and burdens are more significant than objective costs in the decision to participate in the Federal contract market, these data are important in assessing the real burden of Federal contract regulations. While a majority of the cost in making physical facility changes is due to the cost of new equipment or materials, the largest component of work routine costs in Table 5.3 is due to managerial time. Apparently, participation in the Federal contract market and compliance with regulations imposes substantial opportunity costs on firms by diverting managerial and entrepreneurial energy away from other firm functions such as production management, market development and technological innovations. The reported diversion entrepreneurial and of managerial energy is greatest for research contractors and contractors who consider Federal regulations to be either a great burden or a competitive disadvantage.

TABLE 5.3—ALLOCATION OF COSTS ASSOCIATED WITH MAJOR CHANGES IN WORK ROUTINES AND PHYSICAL FACILITIES TO COMPLY WITH FEDERAL REQUIREMENTS

Cost component	Mean percentage allocation	
	Work routines	Physical facilities
New equipment	17.0	52.5
Managerial time	31.0	13.5
Employee time	26.4	13.1
Outside contractors	7.5	14.6
Other costs	18.1	6.2
Total	100.0	99.9
Weighted cases	61	54

Who Pays the Regulatory Costs?

Who pays the regulatory burden is of importance to public policy. The Congressional intent in attaching regulatory conditions to Federal contracts is to achieve regulatory goals and social targets without incurring Federal budgetary costs; that is, socioeconomic regulations are an attempt on the part of the Federal Government to shift the burden of attaining social policy targets onto Federal contractors in the private sector. Forcing private sector contractors to bear the cost of social policy is paradoxical since the Federal Government is attempting to attract private sector firms into the Federal contract market as vendors at the same time. If vendors expect an adequate profit from their sales to the Government, any regulatory burden imposed on these profit margins by procurement regulations must be ultimately borne by the Federal Government in the form of higher contract prices, at least indirectly.

Table 5.4 provides evidence that firm profit margins are not affected substantially by the burden of socioeconomic regulations. When asked "Would you agree or disagree with the statement that Federal contracts provide an adequate profit margin for your firm?", 42 percent of the firms said that they agree or strongly agree with this statement. Another 22.5 percent of the firms neither agreed nor disagreed with this statement, and 34.7 percent felt that profit margins were not adequate.

TABLE 5.4—ADEQUACY OF PROFIT MARGINS FROM FEDERAL GOVERNMENT CONTRACTS THAT "AGREE OR DISAGREE?"

Type of response	Percent response of firms [1]
Agree, profit margins are adequate	42.8
Disagree, profit margins are adequate	34.7
Neither agree nor disagree, profit margins are adequate	22.5
Total	100.0
Weighted cases	705

[1] Percent responses to the question "Do you agree or disagree with the statement that Federal contracts provide an adequate profit margin for your firm?"

The firms that felt profit margins were not adequate usually listed the regulatory burden as their number one problem. They also were the firms that generally agreed that the regulatory burden was greater than they anticipated prior to entering the Federal contract market. This group of firms likewise tended to express the opinion that in the future they will either reduce, or cease entirely, their Federal contract activities.

Since late responding contractors tended to have a more negative view of the contract market, the survey results may overstate satisfaction with profits. Nevertheless, a large percentage of firms were content with the profit margins that they received from selling to the Federal Government. Moreover, a large percentage of contractors intend to continue to bid on future Federal Government contracts. These findings suggest that the regulatory burden, although felt to be large, is not at the expense of private sector rates of return. The implication of this finding is that the costs of Federal contract regulations are ultimately borne by the general taxpayer through higher procurement costs. Although the general perception among responding Federal contractors was that profits are adequate in the Federal contract market, significant differences emerged for different contract categories. Firms holding production and service contracts are more likely to feel that profits are adequate than firms with research contracts (Table 5.5). More than 40 percent of the production and service firms agreed that profits are adequate in contrast to only one-fourth of the research firms.

TABLE 5.5—PERCEIVED ADEQUACY OF FEDERAL CONTRACT PROFITS BY TYPE OF CONTRACT RECEIVED

Profits adequate	Research	Type of contract	
		Production	Service
Agree (percent)	25.0	44.6	43.5
Neither agree or disagree (percent)	26.5	22.3	22.3
Disagree (percent)	48.5	33.1	34.2
Total (percent)	100.0	100.0	100.0
Weighted cases	35	302	412

Additional insights into the nature of the regulatory cost burden at the firm level and the final incidence of this cost is provided in Table 5.6. Each of the firms in the survey were asked to indicate which of the following statements best describes the impact of Federal contract requirements on their firm: 1) they impose a great burden on our company, 2) they offer a competitive disadvantage to our company, 3) they offer a competitive advantage to our company, 4) the effects are eliminated in the long run by competition, or 5) they are a necessary part of doing business with the government. Twenty-nine percent of the firms indicated that the contract requirements imposed a great burden on their company. Another 18.1 percent felt at a competitive disadvantage in the Federal procurement market, reflecting a perception that their competitors possessed a comparative advantage in managing and understanding contract regulations. Nevertheless, 21.7 percent of the firms indicated that they viewed Federal contract requirements as a neces-

sary part of doing business with the Federal Government trying to solve social problems. These firms felt that socioeconomic regulations were simply a necessary cost of doing business with the Federal Government. Interestingly, 19.5 percent of the firms felt that the regulatory burden that was imposed on them by the socioeconomic regulations would be eliminated in the long run. This suggests that they felt the regulatory costs in the long run would be borne by Government, protecting their relative profit margin.

TABLE 5.6—THE IMPACT OF FEDERAL PROCUREMENT REGULATIONS ON SMALL BUSINESS FIRMS

Type of impact of firm level	Percent of responding firms
A great burden on the firm	29.1
Regulations are a necessary cost of selling to the Federal Government	21.7
Impact of regulatory cost eliminated in the long run	19.5
Placed firm at a competitive disadvantage	18.1
Regulations are an advantage to your firm	11.5
Total	99.9
Weighted cases	647

The thesis that the captive theory of regulation is applied to social regulation in the procurement market received some empirical support in the study. Almost 12 percent of the firms indicated that they felt that Federal contract requirements actually gave their firm an advantage. As discussed in Chapter 2, Stigler and others have maintained that the Federal regulatory process has been captured by the private sector which, in turn, has used regulations as a barrier to entry in markets. To some degree, the Wright State University survey found that the capture theory is applicable to the procurement market for goods and services. Social regulations, by creating a large psychological barrier to entry, are perceived by some firms in the procurement market to give them an advantage over potential new entrants. Moreover, as discussed, the majority of firms in the market generally felt that their profit margins are unaffected by these contract provisions. About 12 percent of the firms felt that contract regulations actually gave them a competitive advantage in the procurement market.

As might be expected, contractor perceptions of the impact of contract requirements on their firm vary with the type of contract (Table 5.7). Research contract holders are more likely to consider contract requirements to be both a great burden and a necessary part of doing business with the government. Taken together with their general opinions that profit margins on Federal contracts are inadequate, these data suggest that firms bidding for research contracts are absorbing much of the cost of socioeconomic regulations. Conversely, production and service contract awardees are twice as likely as research respondents to indicate that Federal contract requirements provide a competitive advantage for their firm. Those findings suggest that the capture theory of regulation is more applicable to firms competing for production and service contracts.

TABLE 5.7—PERCEIVED IMPACT OF CONTRACT REQUIREMENTS BY TYPE OF CONTRACT RECEIVED

Impact	Type of contract		
	Research	Production	Service
Great burden (percent)	33.2	25.6	32.8
Disadvantage (percent)	16.6	20.9	15.7
Advantage (percent)	5.3	9.8	11.8
Eliminated in long run (percent)	16.9	20.1	18.3
Necessary part of business (percent)	28.6	23.6	20.4
Totals	100.1	100.0	100.1
Weighted cases	33	280	381

This conclusion that regulatory costs are borne of the Federal Government is further supported by the observations in Table 5.8. Contractors who see a competitive advantage in Federal contract requirements overwhelmingly feel that contract profits are adequate. On the other hand, a large percentage of responding firms who consider the requirements to be either a competitive disadvantage or great burden disagree that profits in the Federal contract market are adequate. Even more interesting is the fact that respondents who feel that the effect of contract regulations is a necessary part of doing business in the Federal contract market or that the effect is eliminated by competition feel that there are adequate profits. Clearly, it appears that most contractors believe that contrary to legislative intent, the Federal Government pays the cost of socioeconomic regulations.

TABLE 5.8—PERCEPTION THAT FEDERAL CONTRACT PROFITS ARE ADEQUATE BY PERCEIVED IMPACT OF CONTRACT REQUIREMENTS

Impact	Adequate profits (percent)			Total percent	Weighted cases
	Agree	Neither agree nor disagree	Disagree		
Great burden	36.9	25.6	37.5	100.0	188
Competitive disadvantage	28.8	20.0	51.2	100.0	114
Eliminated by competition	45.6	23.8	30.6	100.0	126
Necessary part	48.0	26.7	25.4	100.1	138
Competitive advantage	69.9	10.7	19.4	100.0	75

Willingness To Remain in the Contract Market

Most firms have not and do not intend to reduce their Federal contract activity because of government regulations. According to Table 5.9, 64 percent of the firms in the survey indicated that Federal contract activity has not been reduced or terminated because of the regulatory burden. Nevertheless, 32.5 percent of the firms did indicate that Federal contract activity has been reduced and an additional 3.5 percent of the firms said that they have or intend to stop Federal contract activity altogether. Thus, about 36 percent of the firms indicated that the Federal regulatory burden, even though profit margins are generally protected, has made them rethink their willingness to sell goods and services to the Federal

Government. Moreover, the fact that a large number of firms in the survey indicated that they perceived that the regulatory burden would be quite large before they entered the market, suggests that the Federal regulatory burden is having a substantial impact on the decisions of a significant number of firms to remain outside of the Federal contract market. The fact that contractors who responded more slowly to the survey were less likely to participate in the contract market in the future suggests that the percentage of withdrawals may be even larger than the results the survey imply.

TABLE 5.9—CHANGE IN FEDERAL CONTRACT ACTIVITY DUE TO FEDERAL REGULATORY BURDEN

Change in contract activity	Percent of responding firms
No reduction	64.0
Reduced	32.5
Stopped	3.5
Total	100.0
Weighted cases	702

Nearly 90 percent of contractors who stated that contract requirements offer a competitive advantage to their firms have not reduced their Federal contract activity. Conversely, over half of those contractors who feel that the regulations are a great burden, or pose a competitive threat to their firms have reduced Federal contract market activity. Another 5 percent report that they have withdrawn from the Federal contract market.

The Federal contractors who intend to reduce or cease Federal contract market activity list a number of reasons for this decision. As presented in Table 5.10, complexity of contract requirements listed by 66.6 percent of these firms, was the most significant factor. Government delays appeared as a significant factor in 52.8 percent of the responses. Uncertainty about requirements, lack of manager time, the cost of the requirements, and inadequate funds to meet requirements are also listed as factors behind the decision to reduce Federal contract activity.

TABLE 5.10—REASONS FOR REDUCED FEDERAL CONTRACT MARKET ACTIVITY RESULTING FROM GOVERNMENT REGULATORY REQUIREMENTS

Reason for reduced activity	Percent of contractors [1]
Complexity of contract requirements	66.6
Government delays	52.8
Uncertainty about requirements	46.6
Lack of manager time	40.9
Possible cost of requirements	24.0
No funds to meet requirements	20.5

[1] Respondents could indicate more than one reason for reducing participation in the Federal Contract market.

As shown in Table 5.11, there are substantial variations in the reasons for reducing contract activity by type of contract received. Research firms were more likely to mention government delays

and less likely to mention uncertainty about future requirements. Service and production firms focused on the complexity of contract requirements while production firms de-emphasized lack of funds to meet requirements.

TABLE 5.11—REASONS FOR FEDERAL CUTBACKS IN CONTRACT MARKET PARTICIPATION BY TYPE OF CONTRACT

[In percent]

Reason	Type of contract		
	Research	Production	Service
Complexity	56.8	74.7	63.6
Government delays	77.0	44.5	54.0
Uncertainty	36.2	44.4	51.0
Lack of manager's time	42.0	46.5	35.4
Possible cost	21.2	21.0	25.1
No funds	27.9	11.9	23.7

Likewise, reasons for reducing Federal contract participation are associated with a respondent's perception of the impact of Federal requirements on his or her firm in Table 5.12. Firms who say that regulations are a great burden were more likely to mention the lack of managerial time and complexity of regulations as reasons for partial or complete market withdrawal. Firms at a competitive disadvantage tended to focus on government delays.

TABLE 5.12—REASONS FOR CUTBACKS IN FEDERAL CONTRACT MARKET PARTICIPATION BY PERCEIVED IMPACT OF CONTRACT REQUIREMENTS

[In percent]

Reason	Great burden	Advantage	Disadvantage	Eliminated	Necessary
No funds	18.2	0.0	25.0	21.5	18.1
Lack of manager's time	51.3	32.5	39.4	27.3	25.7
Good delay	46.3	51.5	62.8	48.4	60.2
Complexity	77.1	58.2	53.9	67.6	62.3
Possible cost	28.6	0.0	33.9	10.7	12.6
Uncertainty	47.9	38.9	50.8	58.3	32.4

Even firms which did not express such negative evaluations of the impact of regulations on their business stressed factors that involve opportunity costs for entrepreneurs and managers rather than lack of funds to meet contract requirements. The diversion of managerial resources to understand and comply with Federal contract market requirements appears to be the most significant cost to small businesses resulting from socioeconomic contract regulations. It is also the most significant factor in explaining contractor unwillingness to continue to participate in the Federal contract market.

Cost to the Government

This study has emphasized the impact of socioeconomic regulations on small business Federal contractors, but these regulations also have a government cost side. As discussed previously, the evi-

dence indicates that the ultimate cost that is initially imposed on the business community as a result of these regulations is borne by the government sector in the form of higher contract prices. In competitive markets where the government attempts to attract vendors by offering a rate of return for selling to the government, this is hardly a surprising finding. Nevertheless, the largest cost to the government may be in the form of reduced product quality and the loss of entrepreneurial spin-off activities to the rest of the economy. Murray Weidenbaum described the immeasureable effects of government regulations on the basic entrepreneurial nature of the private enterprise system in this way, "To the extent that management's attention is diverted from traditional production development, production, and marketing concerns to meet governmentally imposed social requirements, in significant bureaucratization of corporate activity results." [1]

The Wright State University survey found ample evidence that businesses suffer a considerable diversion of entrepreneurial resources to meet Federal contract requirements. The extent that this occurs, firm production and management quality suffers. If these costs are excessive, the firms withdraw or reduce their Federal contract activity, providing the Federal Government with fewer competitive or alternative sources of suppliers. A lessening of competition can lead to a deterioration in the quality of the procurement process.

Also, to the extent that firms are diverting entrepreneurial activities to meeting governmentally imposed regulatory requirements to meet social goals, they are diverting attention away from productivity and job enhancing activities such as technological innovation and the development of new markets and new products. Regulatory distortions in the entrepreneurial function of corporations may be the single largest cost to society. Although it is an immeasurable impact, the evidence of the Wright State University survey suggests that diversion of entrepreneurial resources is perceived to be a serious cost to firms as a result of having to comply with socioeconomic regulations.

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[1] Weidenbaum, Murray L., "The High Cost of Government Regulation," *Challenge*, November-December 1979, p. 38.

VI. SUMMARY AND CONCLUSIONS

This study raised a number of important questions regarding the impact of socioeconomic regulations on businesses selling goods and services to the Federal Government. A summary of the major findings and a discussion of the conclusions of the study are presented in this chapter.

SUMMARY

The study found that Federal Government procurement is an important source of start up capital for many firms, particularly in the research and service sectors. Moreover, evidence was found that once these firms become stronger and more financially independent, they diversify into nonprocurement markets. Federal contracts as a percent of total revenue were found to decline with the size and age of the firms. Thus, it would appear that the Federal procurement market is an important factor in the nation's overall entrepreneurial climate.

As government vendors expand and diversify, several benefits accrue to the Federal Government and to society. The commercial diversification of Federal contractors strengthens the industrial base upon which the Federal Government depends for the goods and services that it procures. The result of a more competitive vendor community is greater variety in the types and quality of goods and services available. One example is the computer industry which received a major impetus from Federal Government defense contracts in its early stage development. As this industry matured and expanded into other markets, computing power increased at an amazing rate while unit costs declined. The later stage benefits to the Department of Defense, in terms of lower costs and improved quality of computers and related products and service, has been enormous.

Society at large also benefited through the application of computers in the improvement of productivity and product quality. As computer technology became diffused throughout industry and the economy, the nation experienced higher economic growth and job creation. Over the past twenty years the American economy has generated a significantly higher rate of job growth than any other major industrialized nation. Technological innovation has contributed to this development by providing a major stimulus to the maintenance of the long run competitiveness of the American economy.

The Congress has seized on the increasing importance of Federal purchasing power in the American economy in an attempt to achieve a number of social and economic objectives unrelated to the direct procurement of goods and services. This study examined the growth and development of these "socioeconomic laws" and

found that they are ineffective in solving social problems. Their primary impact has been to raise the cost of procurement to Federal Government agencies. Business profit margins were not significantly affected by these regulations, nor was there evidence that corporations significantly alter corporate social policy to be in compliance with the socioeconomic laws. Businesses were not out of compliance with these contract requirements because corporate social policy was found to be in general congruence with the contract regulations affecting minorities, the handicapped, and equal employment opportunity. For example, most businesses felt that hiring and promoting minorities and qualified handicapped individuals was a corporate social responsibility. They were largely unaware that they were required under Federal procurement laws to make "reasonable accommodation" to meet Federally mandated employment objectives.

Socioeconomic laws were found not to have a significant effect on corporate social policy; but, a lack of significant effect was not the case on the cost side of the ledger. Many businesses found the socioeconomic regulations to be a major burden on their corporations. Dollar costs were not reported to be large, but the time spent understanding regulations, completing the necessary paperwork, and the uncertainty caused by inadequate communication of firm responsibilities under the law, were found to be a significant drain on the entrepreneurial and managerial resources of firms. These intrafirm costs were largely compensated for by adequate profit margins in Federal contracts, but the indirect costs to society in terms of reduced "spin off" commercial activity, less innovation, and lower productivity growth are the real costs of excessive procurement regulations.

Procurement laws aimed at solving social problems probably impose a large opportunity cost onto those groups, organizations, and individuals who are the intended beneficiaries of these socioeconomic laws. Attaching social regulations to procurement contracts appears to be a convenient mechanism to solve social problems, but no evidence was found in this study that the expectations of those who support this approach are being realized. If socioeconomic regulation is chosen in lieu of more effective governmental and private sector approaches to solving social problems, the opportunity cost to those in need of government assistance may be quite large.

Conclusions

The concern of the Federal procurement process and professional procurement personnel is the acquisition of goods and services with the overriding consideration of price, quality, and delivery. "Pursuit of extraneous objectives . . . imposes added costs and administrative burdens. At best, these added duties and responsibilities are regarded as nuisances; at worst, they threaten a breakdown of the Government procurement process." [1]

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[1] Herbert Roback, "Government Procurement as a Means of Enforcing Social Legislation," *National Contract Management Journal*, January 1972, p. 13.

While Roback's and the present study's focus is primarily on socioeconomic requirements attached to the Federal procurement process, alleviating the negative costs of such requirements is only part of the procurement reforms necessary. As discussed in Chapter II, there have been two major studies of the entire Federal procurement process.

The first study results and recommendations were issued in 1972 by the Commission on Government Procurement.[2] Three recommendations concerning socioeconomic requirements were included in the total of 149 recommendations. Implementations of the suggested changes has been very slow. In the GAO's final assessment of adoption, it was found that 13 had been rejected, 30 had been accepted, and action on 106 was incomplete.[3] Included in the incomplete set were the three socioeconomic recommendations. More recently, Hampton [4] has found no further progress on these three.

The second major study of the management of the Federal procurement process was undertaken by the National Academy of Public Administration.[5] Adoption of the 18 recommendations in the Academy report would provide valuable reforms to improve the efficiency of the procurement process. Again the Academy report directed attention to consideration of socioeconomic procurement regulations.

Although major Governmental reports have focused attention on the procurement process and socioeconomic contract provisions, the insidious use of socioeconomic regulations has increased in the eleven years between the two reports. Even though some thresholds have been raised, the procurement process is more burdened with socioeconomic contract requirements in 1984 than it was in 1972. Likewise, the cost of such provisions to the American economy, contractors, and the Federal Government is greater today than in 1972.

The present study leads to the following four recommendations:

(1) Congress and the Executive Office of the President should declare an immediate moratorium on the promulgation and enactment of additional socioeconomic clauses attached to Federal contracts for goods and services.

(2) While the moratorium is in effect, the Congress and the President should appoint a Joint Task Force to evaluate major socioeconomic contract provisions to determine whether each is achieving its intended effect as well as what side effects have resulted. These examinations should include:

(a) Specifications of the intended effect including measurable outcomes and projected schedules for attaining the outcomes.

(b) Estimation of the impact of each socioeconomic provision on the costs of Federal procurement inoluding direct

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[2] Commission on Government Procurement, *National Policies Implemented Through The Procurement Process*, Washington, DC, 1972.

[3] *Legislative Recommendations of the Commission on Government Procurement: 5 years later*, PSAD7980, U.S. General Accounting Office, Washington, DC, May 31, 1979, p. 4.

[4] Richard John Hamption, *Achieving Socioeconomic Goals Through the Federal Procurement Process*, Unpublished DBA Dissertation, George Washington University, 1981.

[5] National Academy of Public Administration, "Deregulation of Government Management: Federal Procurement, Interim Report," March 1983.

contractor costs, diversion of entrepreneurial resources, and reduced spinoff activity.

(c) Estimation of the hidden tax paid by the Government in increased contract prices and restricted contract market access.

(d) Specification of alternative policies for achieving the intended effects of each socioeconomic provision.

(e) Estimation of the cumulative cost of multiple socioeconomic contract requirements.

(3) The Task Force should recommend ways to reform of the entire Federal procurement system. This reform should include:

(a) A specific program to improve the professional development of the Federal procurement staff. The establishment of the Federal Acquisition Institute (FAI) in 1976 and the Office of Federal Procurement Policy (OFPP) are significant steps toward an improvement in the professionalization of the procurement process. Their efforts need to be reinforced.

(b) A strategy to revise and implement the provisions of OMB Circular A-76 regarding contracting out for goods and services to utilize private sector resources and contractors in preference to in-house provision of goods and services.

(c) A program to improve public awareness of the attachment of any new socioeconomic requirements to Federal procurement contracts. One way to improve public awareness would be to require the preparation of a "regulatory note" for each intended socioeconomic regulation. Such a note could specify the intended effect, expected side effects, cost to contractors, cost to the Federal government, measurable outcome, timetable, and an evaluation of alternative ways of achieving the same goal as the proposed socioeconomic contract provision.

(4) Based upon the Joint Task Force recommendations, Congress should initiate a major program of procurement reform to remove redundant, inconsistent and ineffective socioeconomic procurement regulations and take the necessary steps to significantly improve the professional management and efficiency of the procurement process.

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APPENDIX A

Business and the Federal Contract Market

The Effect of Contract Regulations

Institute for Community and
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College of Business and Administration
Wright State University
Dayton, Ohio 45435
513/873-2812

WRIGHT STATE

1. Is federal contracting a more dependable market for large firms than for small businesses? (Please circle one number.)

   1 Yes, more dependable for large firms
   2 About the same for both
   3 No, more dependable for small businesses

2. Some people have said that large businesses get the largest and most profitable share of federal contracts and small firms compete for what is left. Do you agree?

   1 Strongly agree
   2 Agree
   3 Not sure
   4 Disagree
   5 Strongly disagree

3. Do small business set asides help smaller companies compete for federal contracts?

   1 Yes, they are essential
   2 Yes, they are useful
   3 They are slightly helpful
   4 No, they are not necessary
   5 No, they hurt rather than help small businesses

4. Do large businesses use smaller companies to get federal contract set asides?

   1 Yes
   2 No
   3 Not sure

5. How important was the ability to get federal contracts in the start-up of your business?

   1 Essential
   2 Very important
   3 Important
   4 Somewhat important
   5 Little or no importance

6. Please rank the following four problems for small business according to how much each has affected your own business. Use 1 for the most important problem.

   Rank
   ____ Taxation
   ____ Competition from large business
   ____ Inflation
   ____ Federal regulations (inspections, contract compliance requirements, etc.)

7. About what percentage of your annual sales come from federal contracts?

   1 Less than 10%
   2 10% to 25%
   3 26% to 50%
   4 51% to 75%
   5 76% to 90%
   6 More than 90%

8. Would you agree or disagree with the statement that federal contracts provide an adequate profit margin for your firm?

   1 Strongly agree
   2 Agree
   3 Neither agree nor disagree
   4 Disagree
   5 Strongly disagree

9. Which of the following persons are employed by your firm? (Circle as many as necessary.)

1 Accountant on staff
2 Accountant on call
3 Lawyer on staff
4 Lawyer on call
5 Manager for federal contracts marketing
6 Consulting firm to deal with federal contract officers

10. Is your company likely to bid on federal contracts in 1981 or 1982?

1 Very likely
2 Likely
3 Somewhat likely
4 Somewhat unlikely → 10a. Why not? _____
5 Unlikely
6 Very unlikely

10b. Have the federal regulations on the handicapped and veterans affected this likelihood?

1 Increased likelihood
2 No change
3 Decreased likelihood

11. Have paperwork and delays involved in federal contracting made you more or less likely to seek federal contracts?

1 Much more likely
2 Likely
3 Somewhat likely
4 No difference
5 Somewhat unlikely
6 Unlikely
7 Much less likely

12. How much assistance has the SBA provided your company in federal contract work?

1 Much assistance
2 Some assistance
3 Little assistance
4 No assistance

13. How helpful are contractor pre-bid conferences in understanding contract requirements and regulations?

1 Very helpful
2 Helpful
3 Somewhat helpful
4 Little help
5 No help at all

14. Were you made aware of the federal regulations on employing veterans and handicapped individuals during pre-bid conferences?

1 Yes
2 No
3 Not sure

15. How confident are you that you understand the meaning of "reasonable accommodation" for handicapped employees, who are otherwise qualified, as defined in federal regulations?

1 Fully confident
2 Very confident
3 Somewhat confident
4 Less than confident
5 Reasonable accommodation has never been explained to me

16. Some small businessmen have said that their knowledge of federal contract regulations and requirements gives them a competitive advantage in the federal contracting market. Do you agree or disagree?

    1 Strongly agree
    2 Agree
    3 Neither agree nor disagree
    4 Disagree
    5 Strongly disagree

17. Before entering the federal contracting market, did you think that government regulations and contract requirements would be an initial barrier to getting into the market?

    1 Definitely, major barrier
    2 Yes, but minor barrier
    3 No

18. Do you now see the regulatory requirements and procedures as more or less of a burden than you expected before entering the market?

    1 Much more of a burden
    2 More of a burden
    3 About the same as expected
    4 Less of a burden
    5 Much less of a burden

19. In bidding on federal contracts, do you consider the ability of other bidders to understand contract requirements?

    1 Yes
    2 No
    3 Not sure

20. Should the federal government use contract requirements to solve social problems such as employment discrimination? (Please circle one number.)

    1 Yes
    2 No
    3 No, because it is inefficient
    4 Not sure

21. Some businesses have avoided federal contracts because of contract requirements. Other businesses have reduced their contract activity because of the requirements. Has your federal contract activity been affected by contract requirements?

    1 Contract activity has not been affected
    2 Contract activity has increased
    3 Contract activity has been reduced
    4 Contract activity has been stopped

22. If you have reduced or stopped federal contract activity because of contract requirements, why? (Circle as many numbers as necessary.)

    1 Lack of funds to meet requirements
    2 Lack of manager's time
    3 Government delays
    4 Complexity of contract requirements
    5 Possible cost of requirements even though the money is available
    6 Uncertainty about how requirements will be enforced

23. Small businesses must comply with many contract requirements in order to work federal contracts. Which of the following best describes your view of the impact of contract requirements? (Please circle one number.)

    1 Contract requirements impose a great burden on our company
    2 Contract requirements offer a competitive advantage to our company
    3 Contract requirements offer a competitive disadvantage to our company
    4 The effect of requirements is eliminated in the long run by competition
    5 Contract requirements are a necessary part of doing business with a government trying to solve social problems

24. With which of the following government agencies has your business been in contact with during the last year?

	Type of Contact				Impact on Business		
Agency	No Contact	Inspected or Investigated by	Ordered to Comply by	Received Information from	Little	Moderate	Great
Environmental Protection Agency (EPA)	1	2	3	4	1	2	3
Department of Labor (DOL)	1	2	3	4	1	2	3
Department of Defense (DOD)	1	2	3	4	1	2	3
Office of Federal Contract Compliance Programs (OFCCP)	1	2	3	4	1	2	3
Department of Energy (DOE)	1	2	3	4	1	2	3
Consumer Product Safety Commission (CPSC)	1	2	3	4	1	2	3
Food and Drug Administration (FDA)	1	2	3	4	1	2	3
Federal Trade Commission (FTC)	1	2	3	4	1	2	3
Occupational Safety and Health Administration (OSHA)	1	2	3	4	1	2	3
Equal Employment Opportunity Commission (EEOC)	1	2	3	4	1	2	3
Interstate Commerce Commission (ICC)	1	2	3	4	1	2	3
Census Bureau	1	2	3	4	1	2	3
Department of Transportation (DOT)	1	2	3	4	1	2	3
Department of Health and Human Services	1	2	3	4	1	2	3
Department of Housing and Urban Development (HUD)	1	2	3	4	1	2	3
Small Business Administration (SBA)	1	2	3	4	1	2	3
Securities and Exchange Commission (SEC)	1	2	3	4	1	2	3

25. Which of the federal agencies listed above have the most impact on the way you operate your business?

1 _____

2 _____

3 _____

26. Has your business made any changes in the following work practices to comply with Equal Employment Opportunity requirements?

	Veterans/Handicapped		Other than Veterans/Handicapped	
a. Hiring	Yes	No	Yes	No
b. Promotion	Yes	No	Yes	No
c. Training	Yes	No	Yes	No
d. Recruitment	Yes	No	Yes	No
e. Layoffs	Yes	No	Yes	No
f. Insurance	Yes	No	Yes	No

27. Since 1976, has your business made any major change in **work routines** (operating hours, training, employment interviewing, employee assistance, etc.) or any major change in its **physical facilities** (new equipment, plant renovation, alteration of existing plant or equipment, etc.) to comply with federal government employment and working requirements?

1 Major change in work routines
2 Major change in physical facilities
3 Major changes in both
4 No major changes

Important Work Routine Change

Type of change _____
Agency requiring change _____
Year _____

Approximate cost of change

1 $100 or less
2 $101 to $500
3 $501 to $1000
4 $1001 to $2500
5 $2501 to $5000
6 More than $5000

Indicate what percentage of cost was due to new equipment or materials.

0% 20% 40% 60% 80% 100%

Indicate what percentage was due to managerial time spent supervising and implemanting the change.

0% 20% 40% 60% 80% 100%

Indicate what percentage was due to employee time spent implementing the change.

0% 20% 40% 60% 80% 100%

Indicate what percentage was spent on outside contractors or consultants.

0% 20% 40% 60% 80% 100%

Indicate what percentage was due to other costs.

0% 20% 40% 60% 80% 100%

How has this change affected your annual operating costs?

1 No change
2 Decreased operating costs → What is the annual increase or decrease?
3 Increased operating costs → What is the annual increase or decrease?

1 Less than $500
2 $501 to $1000
3 $1001 to $2500
4 $2501 to $5000
5 More than $5000

Important Physical Facility Change

Type of change _____
Agency requiring change _____
Year _____

Approximate cost of change

1 $100 or less
2 $101 to $500
3 $501 to $1000
4 $1001 to $2500
5 $2501 to $5000
6 More than $5000

Indicate what percentage of cost was due to new equipment or materials.

0% 20% 40% 60% 80% 100%

Indicate what percentage was due to managerial time spent supervising and implementing the change.

0% 20% 40% 60% 80% 100%

Indicate what percentage was due to employee time spent implementing the change.

0% 20% 40% 60% 80% 100%

Indicate what percentage was spent on outside contractors or consultants.

0% 20% 40% 60% 80% 100%

Indicate what percentage was due to other costs.

0% 20% 40% 60% 80% 100%

How has this change affected your annual operating costs?

1 No change
2 Decreased operating costs → What is the annual increase or decrease?
3 Increased operating costs → What is the annual increase or decrease?

1 Less than $500
2 $501 to $1000
3 $1001 to $2500
4 $2501 to $5000
5 More than $5000

28. How would you describe the impact of Equal Employment Opportunity and Affirmative Action requirements on your business?

_____

_____

29. Assuming that an employee were otherwise qualified to work for you, which of the following handicaps would make it difficult for an employee to work in your operations and why?

	Employable		Reason for Employment Difficulty								
			Needs special equipment	Heavy loads	Stress	Machine danger	Building inaccessible	Interfere with other workers	Insurance	Need supervision	Restrooms inaccessible
a. Drug abuse history	Yes	No	1	2	3	4	5	6	7	8	9
b. Blind/visually impaired	Yes	No	1	2	3	4	5	6	7	8	9
c. Mental illness history	Yes	No	1	2	3	4	5	6	7	8	9
d. Heart/respiratory illness history	Yes	No	1	2	3	4	5	6	7	8	9
e. Deaf/hearing impaired	Yes	No	1	2	3	4	5	6	7	8	9
f. Alcohol abuse history	Yes	No	1	2	3	4	5	6	7	8	9
g. Cancer history	Yes	No	1	2	3	4	5	6	7	8	9
h. Amputation of limb	Yes	No	1	2	3	4	5	6	7	8	9
i. Physical mobility limitations, such as a wheelchair	Yes	No	1	2	3	4	5	6	7	8	9
j. Epilepsy	Yes	No	1	2	3	4	5	6	7	8	9
k. Other _____	Yes	No	1	2	3	4	5	6	7	8	9

30. About how many of your employees have been identified as handicapped? _____

a. About what percentage of your workforce is this? _____ %

b. Which of the following handicaps do your employees have? (Circle as many numbers as necessary.)

1 Impaired vision
2 Impaired hearing
3 Impaired mobility
4 Nervous system impairment
5 Psychological or learning impairment
6 Heart or circulatory problems
7 Impaired respiration
8 Loss of limb(s)
9 Employee with more than one handicap
10 Other (Please specify) _____

31. How has your employment of handicapped workers been affected by information which you have received by being in the federal contract market?

1 Greatly increased
2 Increased
3 Slightly increased
4 No change at all
5 Slightly decreased
6 Decreased
7 Greatly decreased

32. Which of the following policies have you adopted to accommodate the employment needs of handicapped employees whether or not you presently have any handicapped employees?

	Have Done		Done to Comply with Federal Regulations	
a. Job Restructuring—examples include Flexitime for workers or grouping physically demanding job tasks within a new job description	Yes	No	Yes	No
b. Physical Facilities—examples include wheelchair ramps, accessible bathrooms, teletype machines, amplifying telephones, variable height work stations, devices for reaching or gripping, and air conditioning	Yes	No	Yes	No
c. Employee Support Services—examples include personal assistants, pooled transportation to and from home, and counseling	Yes	No	Yes	No
d. Training—examples include special orientation to the work site and training supervisors and other employees to adjust to the handicapped	Yes	No	Yes	No
e. Employment Office—examples include physical modifications, setting up an office in an accessible location, training employment counselors, and seeking qualified handicapped applicants through handicapped organizations	Yes	No	Yes	No
f. Others _____	Yes	No	Yes	No

33. If affirmative action for qualified handicapped employees was strictly enforced, this might have both positive and negative effects on your business. What effects would you expect?

a. Positive effects _____

b. Negative effects _____

We would appreciate your comments on federal contracting.

We would also appreciate your comments on the effect of federal regulations on small businesses.

Thank you for your cooperation.

In appreciation of your time, we will make a contribution to one of the agencies below. Please circle the number of the agency which you prefer.

1 United Cerebral Palsy
2 American Cancer Society
3 American Heart Association
4 Multiple Sclerosis Foundation
5 Easter Seal Foundation

Please check if you would like to be listed as a contributor. ☐

Name to be listed _____

APPENDIX B

MAJOR SOCIOECONOMIC LAWS*

Program	Authority	Purpose
Improving working conditions:		
Walsh-Healey Act	41 U.S.C. 36–45	To prescribe minimum wage, hours, age, and working conditions for supply contracts over $10,000.
Davis-Bacon Act	40 U.S.C. 276a–1–5	To prescribe minimum wages, benefits, and work conditions on construction contracts in excess of $2,000.
Service Contract Act of 1965	41 U.S.C. 351–358	To prescribe wages, fringe benefits, and work conditions for service contracts over $2,500.
Contract Work Hours and Safety Standards Act.	40 U.S.C. 327–330	To prescribe 8-hour day, 40-hour week, and health and safety standards for laborers and mechanics on public works over $2,500.
Fair Labor Standards Act of 1938	29 U.S.C. 201–219	To establish minimum wage, maximum hours standards and overtime pay provisions for employees engaged in commerce or the production of goods for commerce.
Favoring disadvantaged groups:		
Equal employment opportunity provisions.	Executive Order 11246 of October 24, 1965, and Executive Order 11375 of October 13, 1967.	To prohibit discrimination in Government contracting.
Equal employment opportunity clause.		To prohibit discrimination in Government contracts greater than $10,000.
Affirmative Action Program		To require a written program of specific actions in the EEO area by companies having Federal contracts of $50,000 or more and 50 or more employees.
EEO compliance review		To conduct on site reviews of contractor actions in support of the affirmative action program for those contractors with Federal contracts of $1,000,000 or more.
Small Business Act	15 U.S.C. 631–647	To place fair portion of Government purchases and contracts with small business concerns.
Section 8a	15 U.S.C. 637 and 13 C.R.R. 124	To allow the procuring agency to contract with the Small Business Administration who in turn contracts with small or minority business firms.
Utilization of Small Business concerns.		To require all contractors who have Federal contracts greater than $5,000 to accomplish the maximum amount of subcontracting through the use of small business.
Small Business subcontracting program.		To require in certain contracts greater than $500,000 the establishment of a program of subcontracting which will enable small business concerns to be considered fairly as subcontractors and suppliers.

* A Reproduction of Appendix H in Richard John Hampton, "Achieving Socioeconomic Goals through the Federal Procurement Process."

Program	Authority	Purpose
Small Business set-asides		To provide preferential treatment for small business by allowing exclusive participation of small business concerns in set-aside procurements.
Labor surplus area concerns	15 U.S.C. 644 and Executive Order 12073 of August 16, 1978.	To provide preference to concerns performing in areas of concentrated unemployment or underemployment.
Utilization of labor surplus area concerns.		To require contractors with contracts between $5,000 and $50,000 to use best efforts to place contracts with firms in labor surplus areas.
Labor surplus area subcontracting program.		To require specific action of contractors with contracts greater than $500,000 which will aid in awarding subcontracts to firms in labor surplus areas.
Labor surplus set-asides		To require award of partial set-asides to firms in labor surplus areas by the Government.
Prohibition of price differential	Public Law 95–457 sec. 824 (DoD Appropriation Act of 1979).	To prohibit use of appropriate funds for payment of price differential on contracts made to relieve economic dislocation.
Minority business	Executive Order 11625 of October 13, 1971.	To require the use of minority business enterprises as subcontractors as much as possible for defense procurement.
Utilization of minority business		To require the utilization of minority business enterprises to the greatest extent possible on contracts greater than $5,000.
Minority Business Subcontracting Program.		To require the establishment and conduct of a program to enable minority business enterprises to be considered fairly as subcontract under Federal contracts greater than $500,000.
Employment of the handicapped	29 U.S.C. 793 and Executive Order 11758 of January 15, 1974.	To require Government contractors to take affirmative action to employ and advance handicapped individuals.
Listing of employment openings to assist veterans.	38 U.S.C. 2012 (Public Law 92–540 and Executive Order 11701 of January 24, 1973.	To require the listing of all suitable employment openings with the appropriate office of the Federal-State employment service system.
Prison-made products	18 U.S.C. 4121–4128	To require mandatory purchase of specific supplies from Federal Prison Industries, Inc.
Blind-made products	41 U.S.C. 46–48	To make mandatory purchase of products made by blind and other handicapped persons.
Women's Business Enterprise Policy.	Executive Order 12138 of May 18, 1979.	To provide Federal awards to women owned business.
Favoring American companies:		
General Preference		
Buy American Act	41 U.S.C. 10a–10b	To provide preference for domestic materials over foreign materials.
Balance-of-Payments Program	DAR 6–805.2 and FPR 1–6.8	To limit purchase of foreign end products and services use abroad.
Preference for U.S. products (military assistance programs).	22 U.S.C. 2354(a)	To require the purchase of U.S. end products for the military assistance program.
Preference for American sources of specific materials.		
Preference for U.S. clothing, fibers and specialty metals (Berry amendment).	Public Law 95–457 (DoD Appropriation Act of 1979).	To restrict the Department of Defense from purchasing specified classes of commodities of foreign origin.
Ball bearings and timing devices	Executive Order 11490 of October 28, 1969 and DAR 1–2207.	To insure the continued existence of an industrial base for those products necessary for national defense.
Acquisition of foreign buses	Public Law 90–600, (DoD Appropriation Act of 1969), sec. 404.	To restrict use of appropriated funds to purchase, lease, rent, or otherwise acquire foreign manufactured buses.
Prohibition of construction of naval vessels in foreign shipyards.	Public Law 91–171 (DoD Appropriation Act 1970), Title IV.	To prohibit use of appropriated funds for the construction of any Navy vessel in foreign shipyards.

Program	Authority	Purpose
Preference for U.S.-flag air carriers.	49 U.S.C. 1517	To require the use of U.S.-flag air carriers for international air transportation of personnel or property.
Preference for U.S. vessels	10 U.S.C. 2631. 46 U.S.C. 1241	To require a shipment of all military and at least half of other goods in U.S. vessels.
Preference for American construction materials abroad.	22 U.S.C. 295a	To provide preference for domestic manufacturers in construction of diplomatic and consular establishments.
Required source for jewel bearings	DAR 7-104.37	To preserve a mobilization base for manufacture of jewel bearings.
Required source for aluminum ingot.	DAR 1-327, FPR subpart 1-5.10	To eliminate excess quantity of aluminum in the national stockpile.
Identification of expenditures in the United States.	DAR 6-807	To require the reporting of the amount of procurement of U.S. end products accomplished under the balance-of-payments program.
Restriction on R&D contracting with foreign sources.	Public Law 92-570, sec. 744 (DoD Appropriation Act of 1973).	To prohibit the entering into a contract with a foreign entity for performance of R&D on military systems which can be carried out by a U.S. corporation at a lower cost.
Protecting the environment and quality of life:		
Clear Air and Water Acts	Executive Order 11738 of September 18, 1973.	To prevent the award of contracts over $100,000 to businesses that are in violation of the Clean Air and Clean Water Acts, 42 U.S.C. 1857 and 33 U.S.C. 1251 respectively.
Humane Slaughter Act	7 U.S.C. 1901-1906	To purchase meat only from suppliers who conform to humane slaughter standards.
Noise Control Act	42 U.S.C. 4914	To provide a monetary preference to low noice admission products in Federal procurements.
Resource Conservation	42 U.S.C. 6962	To mandate the procurement of items composed of the highest percentage of recovered materials.
Energy conservation	42 U.S.C. 6361 Executive Order 11912 of April 13, 1976.	To mandate the consideration of relative energy efficiency of goods and services capable of satisfying the Government's needs.
Other government purposes:		
Use of excess and near excess currency.	DAR 6-1100, FPR 1-6.704-806	To provide preference and award to bidders willing to be paid in excess or near-excess foreign currency.
Purchases in Communist areas	DAR 6-401 et seq	To prohibit acquisition of supplies from sources within Communist areas.
Nonuse of foreign-flag vessels engaged in Cuban and North Vietnam trade.	DAR 1-1410	To prohibit contractor from shipping any supplies on foreign flag vessel that has called on Cuban or North Vietnamese ports after specific dates.
Convict Labor Act	18 U.S.C. 4082 and Executive Order 11755 of December 29, 1973.	To prohibit employment on Government contracts of persons imprisoned at hard labor.
Duty-free entry of Canadian supplies.	DAR 6-605	To further economic cooperation with Canada and continental defense.
Miller Act	40 U.S.C. 270a-d	To require contractor to provide payment and performance bonds on Government construction contracts.
Copland "Anti-Kickback" Act	18 U.S.C. 874, 40 U.S.C. 276c	To prohibit kickbacks from employees on public works contracts.
Gratuities	10 U.S.C. 2207	To provide the Government with right to terminate if gratuity is given to a Government employee to obtain contract or favorable treatment.
Covenant against contingent fees	10 U.S.C. 2306(h)	To void contract obtained by broker for a contingent fee.
Officials not to benefit	41 U.S.C. 22	To prohibit members of Congress from benefiting from a Government contract.

Program	Authority	Purpose
Offset provisions	Sales agreements with foreign countries.	To provide for purchases from foreign contractors by U.S. Government agencies or contractors as consideration for foreign government purchases from U.S. contractors.
Anti-Inflation Program	Executive Order 12092 of November 1, 1978.	To require the use of the acquisition process as one tool to decelerate the economy.
Geographic distribution of DoD subcontract dollars.	Public Law 95–111 (1978 DoD Appropriation Act).	To require the reporting to Congress of annual geographical distribution of DoD subcontract dollar.
Privacy Act	5 U.S.C. 552a	To make provisions of the Privacy Act applicable to a system of records designed, developed, operated or maintained on behalf of a federal agency.

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